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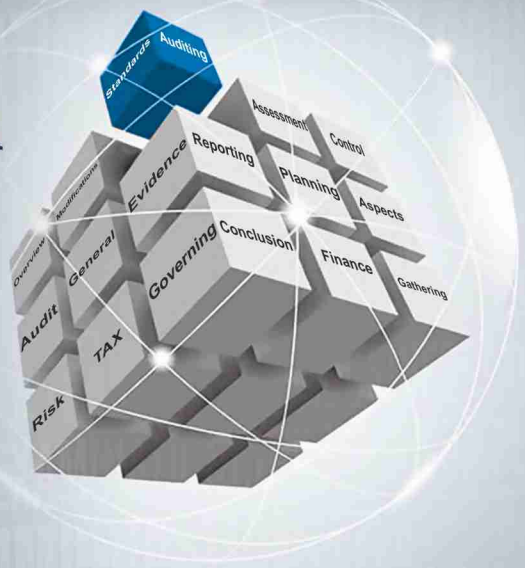
The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

Vol. VI | No. 11 August 2018

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

Standards on Auditing



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Gateway to Professional Growth

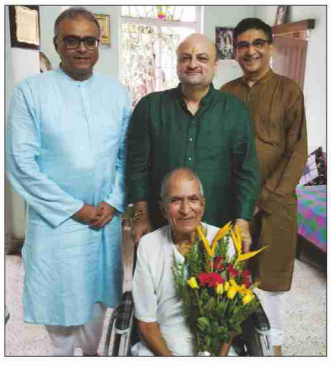
Log on to The Chamber's revamped website

www.ctconline.org

Online payment for programmes can be done through website

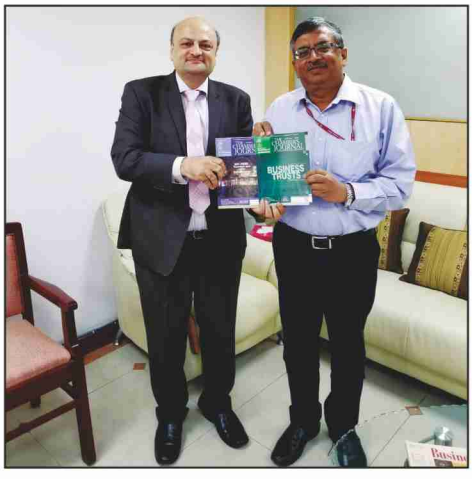
Corporate Connect Committee

Round Table Meeting on Cross-Border Insolvency Regulations with Dr. Navrang Saini, Wholetime member – IBBI held on 12th July, 2018 jointly with Indian Institute of Insolvency Professsionals of ICAI in association with The Institute of Chartered Accountants of India

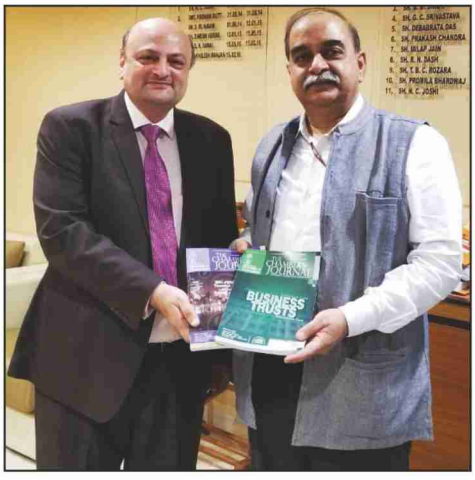


Office Bearers with Shri V.H. Patil, Past President

Seen from L to R S/Shri Anish Thacker, Hon. Jt. Secretary, Hinesh Doshi, President, Vipul Choksi, Vice-President



CA Hinesh Doshi, President, met with Mr. Rajat Bansal JS-FT & TR, CBDT New Delhi and discussed CTC activities and events



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THE CHAMBER OF TAX CONSULTANTS
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The Chamber's Journal

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MEMBERSHIP FEES & JOURNAL SUBSCRIPTION FOR THE F.Y. 2017-18

Sr. No.	Membership Type		Fees	GST 18%	Total
1.	Life Membership (W.e.f. 1-7-2017)	₹	12000	2160	14160
2.	Journal Subscription (Life Members)	₹	1200	0	1200
					₹ 15360
3.	Admission Fees – Ordinary Members	₹	500	90	590
4.	Ordinary Membership Fees	₹	2200	396	2596
					₹ 3186
5.	Admission Fees – Associate Members	₹	1000	180	1180
6.	Associate Membership Fees	₹	5000	900	5900
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Editorial

The past one month had been an eventful month. We all were witness to a Parliamentary session which was highly productive. This may be a sign of changing times for the better. However, what disturbs me is the recurring disruption of normal life in the name of protests. The protests, by some groups, seeking reservation are back and they are disrupting normal life of the citizens in the State of Maharashtra, which is one of the progressive States of the country. The community seeking reservations is a community which has fought against any kind of persecution and tyranny in the past. It is not a marginalised social group. It is a dynamic, vibrant social group which has embraced and forced social reforms in the society in an emphatic manner. When such social groups resort to protests seeking reservation, which have turned violent and tragic at times, it is a wake up call for the conscience keepers of the society. They have to have a hard and deep look at the social disquiet in the society. The source of this anguish in various sections of the society, may be, lies in wrong priorities of our policy makers or in pursuing wrong policies with respect to education and employment.

Well-known author and historian Ramchandra Guha in his book "India After Gandhi" at page 114 has referred to the discussion which took place in the Constituent Assembly, with respect to the extension of reservation to jobs in Government. H. J. Khandekar strongly made out a case for reservation by stating that "You are responsible for our being unfit today. We were suppressed for thousands of years. You engaged in your service to serve your own ends and suppressed us to such an extent that neither our minds nor our bodies and nor even our hearts work, nor are we able to march forward. This is the position. You have reduced us to such a position and then you say that we are not fit and that we have not secured the requisite marks. How can we secure them."

In the debate following the above statement "One thought that 'those persons who are clamouring for these seats, for reservations, for consideration, represent a handful of persons, constituting the cream of Harijan Society'. These were the 'Politically powerful' among these groups. For the left-wing Congress politician Mahavir Tyagi, reservations did not lead to real representation. For 'no caste ever gets any benefit from this reservation. It is the individual or family which gets benefits'. Instead of caste, perhaps there might be reservation by class, such that cobblers, fishermen and other such classes send their representatives through reservations because they are the ones who do not really get any representation".

You all may be wondering what is the need for me to discuss this over here. I want, all who are involved in intellectual activity, to consider the following points.

(i) Lots of water has flown down the river Ganga since the above discussion took place in the Constituent Assembly. But still there are seekers for reservation.

(ii) As the demand for reservations has expanded, one can presume that the same has benefitted the people who availed it. At least other groups seem to believe that it is an advantage for the community having reservations in this ruthless world of competition.

(iii) The section of the society, which now seeks reservations, is not marginalised or downtrodden. They wield substantial political clout. They are in a position to influence the political decisions.

(iv) Why such sections of society are desperate to get protective layer of reservation?

(v) As a society, have we failed to create a society which ensures equal opportunities and security to all? Why the section of the society which is predominantly middle class is so much anguished?

As a conscious society we may have to start working on several corrective measures without leaving these issues to the Government. The solutions to some issues lie with the society rather than with the Government which the society elects in a democracy.

A lot has changed from those times. The aspirational India is looking for opportunities to rewrite the destiny of this sub-continent. If we fail provide them opportunities the youth will waste energy in these disruptive activities.

The special story for the month of the August 2018 is Standards on Auditing. Very eminent professionals have spared their valuable time to contribute to T+he Chamber's Journal. I am grateful to all of them. I thank all the contributors for their support. Wish You All a very Happy Independence Day.

K. GOPAL
Editor

From the President

"Ex nihilo nihil fit"

… is a famous Latin saying which means "Nothing is created from Nothing!"

Dear Members & Students,

In this 72nd year of independence, India is poised to become one of the fastest growing economies in the world . The enthusiasm to turn these challenges into opportunities is the strength which will pave our way for a better tomorrow. With various Government-driven initiatives like the *Swachh Bharat Abhiyaan*, Clean Ganga, Make-in-India, Startup India, Mudra Bank, Skill India, and Jan Dhan-Aadhaar-Mobile, the Government is trying to project an impact of Brand-India world over.

For the first time in 17 years, China records its first current account deficit of $28.3 billion in the first half of this year. The resurgence of 'nativism and protectionism' in the West is a disturbing phenomenon and will lead to economic war amongst countries.

The time has come to completely reorient our public and social discourses towards objectives that will enable India to help build a new India where nobody thinks in terms of caste, religion or region and places the country's interest above anything else. A huge national awakening is needed to convert our *Swarajya* into *Surajya* and ensure that every Indian is part of an inclusive growth story as envisioned by our freedom fighters and founding fathers of our constitution.

Our Government, through its actions, has shown that it stands as a staunch supporter of the phrase 'Nothing is created from Nothing'!. We, at the Chamber of Tax Consultants, also pursue the same concept through continuous efforts to spread knowledge and impart learning so as to aid our professional members. We provide a platform to those professionals who wish to payback to the society. We promote qualitative contribution to the society rather than quantity. After all, nothing is created from nothing and we will not see change if we change nothing. And hence, as much as we see our institution as a pillar of imparting knowledge, we also see our *alma mater* as a valued-partner in nation building and a contributor in changing the face of this great nation!

We saw a lot of exciting happenings this month! A hug and a wink saw the ruling and opposition sharing some light moments. I am reminded of Shri APJ Abdul Kalam's words, "This nation needs developmental politics where the ruling and opposition will work together towards the progress of this nation"! Today, we miss this iconic missile man, who often quoted, "A man's last good bye should be the shortest one"! It's been three years since he breathed his last, doing the thing he loved most – teaching at IIM Shillong but he'll always remain immortal through his contributions and teachings.

REGULATORY UPDATES

The Central Government has released the final notification under Section 115JH of the Income-tax Act, 1961 to address grey areas in the taxability of foreign companies newly treated as resident in India on account of their place of effective management. The tax consequences specified need to be studied and implemented carefully and diligently to avoid misreporting.

The Supreme Court recently overruled its 21-year-old verdict to hold that the benefit of any ambiguity in tax exemption notifications must be interpreted in favour of the State whereas until now, it was in benefit of assessee as per its own decision in a 1997 case. The Apex Court ruled that the onus of proving applicability

of benefit would now be on the assessee, to show that their case comes within the parameters of the exemption clause or exemption notification.

CHAMBER NEWS

JULY EVENTS

We saw a lot of lively events by the Chamber this month. The half-day workshop on Return Filing held at Andheri in suburban Mumbai saw an overwhelming response while the Round Table meeting on Cross Border Insolvency organised jointly with ICAI, IBBI and IMC turned out to be a successful meet. The meeting with TDS Commissioners on online application and processing of TDS applications with WIRC of ICAI was very helpful.

There was a Webinar conducted on 'Managing Challenges of Peak Period Income Tax-Filing'.

The meeting in Delhi with Mr. Akhilesh Ranjan, Director General (International Taxation & Transfer Pricing), Dr. Kirit Somaiya MP and Mr. Rajat Bansal, Jt. Secretary (FT & TR-II, CBDT) on CTC events and activities proved to be extremely fruitful. Further, in the meeting with the GST Commissioner Maharashtra, Mr. Rajiv Jalota, various issues of GST compliances and its procedural matters were discussed.

The Satyanarayana Pooja on the auspicious day of Ashadi Beej saw a good turnout from members and their families. It is indeed a bright start to the year which lies ahead of us.

EVENTS IN AUGUST

The public meeting on 'Panel Discussions on GST - Pains, Gains and Way Forward' conceptualised by Mr. A. R. Krishnan and great efforts put in by Mr. Naresh Sheth and the committee members saw attendance of 250 plus participants on a working day. The panellists were from different spheres of society and gave their views on GST implementation in India. Mr. V. K. Garg, Special Advisor to CM, Punjab, specially came to Mmbai for this event.

We are geared up for the full day seminar on Practical Issues in Company and Tax audit to be conducted on 18th August. Considering the tremendous onus placed on tax auditors via the recently amended Tax Audit Report (Form 3CD), discussion on the challenges and apparent issues is a must. We are also sending out representations to the CBDT to provide further clarification or relaxations in the responsibilities now placed on the tax auditor.

The two-day programme on Ind-AS to be held on 25th August and 1st September, 2018 would facilitate understanding various recent developments in the reporting of Financial Statements. This programme also entails deliberation on other regulatory aspects like GST, Income Tax, Minimum Alternate Tax (MAT) integrated with principles of Ind-AS.

A one-of-a-kind seminar on the intricacies of blog writing and creating presence on LinkedIn is a much sought-after skill being imparted through the Chamber this month-end.

The Chamber is fostering its partnership with BCAS through the "Full-day seminar on Charitable Trusts" covering critical aspects, various issues faced in its compliance and regulatory responsibilities.

"Man is so made that he can only find relaxation from one kind of labour by taking up another" – ***Anatole France***

The next eye-catcher after the Croatia and France match would be the **4th CTC Football Cup Final**. It would be elating to watch the bosses take on a new "Field" to showcase their prowess. 25 teams of CA firms have enrolled including 4 women's teams. Office teams donning the hat of football teams is set to bring a new kind of get-together. We, at the Chamber hope every player takes home the team spirit garnered at this event to bring fresh perspectives on the work front and team building.

SOCIAL MEDIA PRESENCE

Apart from planning and organising these rousing events, the Chamber has also tied up with media partners – Newspapers *Vyapar* and *Janmabhoomi* including tie-ups with various TV channels and newspapers to spread its wings and cover the CTC events and updates on a wider scale. In this digital age, where presence on social media has become more of a necessity than a privilege, partnership with media houses has become imminent to broaden the reach of the Chamber's activities.

REPRESENTATIONS BY THE CHAMBER

The Chamber has been consistently trying to work closely with the Government and its departments on the various amendments as well as updates and providing representations wherever necessary to establish a favourable situation for the taxpayers and at the same time, to ensure the growth and development of the economy in a coherent manner.

1. In line with above, our plea to CBDT for extension of the Income-tax return filing due date was granted, much to the joy of our professional brothers.
2. To bring out a change in the Ease-of-doing-business in India, the Chamber has recently created a committee to send out representations to the Government to propel the global ranking of India in Ease-of-doing-business.
3. The Chamber has also put in representations to the CBDT for "Issues faced by Professionals and Assessee's for compliance with Section 197" and filed representations with Government to take serious note of Central Action Plan dealing with "Targets for CIT(Appeals) and incentive for quality orders".
4. The Chamber has filed representations to the Securities and Exchange Board of India (SEBI) with respect to the Compulsory delisting of 554 companies at BSE and NSE Ltd.
5. This month, the Chamber is also in the process of sending Representations on Significant Economic Presence (SEP) to CBDT.

SPECIAL THEME FOR AUGUST CTC JOURNAL

The Institute of Chartered Accountants of India (ICAI) has revised Standards on Auditing (SA) so as to bring it in parity with revised auditing standards issued by The International Auditing and Assurance Standards Board (IAASB). Most of the SAs will be effective for Financial Statements period beginning from 1st April 2018. The new format for auditor's reporting requirement has already been effective in several countries, including China, Australia, Singapore, Malaysia and certain countries in Europe. The UK was one of the first countries to roll out these requirements. The changes to the auditor's report will provide reader's, benefit of Auditor's Focus, Increased attention and enhanced communication. I thank all the authors for their painstaking effort to write articles for this issue.

PUBLICATIONS

The Publications of CTC have been received with great gusto. Very few copies of the "101 Supreme Court Landmark Judgments" are currently on shelves. Further, the much anticipated publications "FEMA – Fundamental Aspects and Practical Issues" , "Key Rulings under the Indirect Tax laws – A GST perspective" and "The Prevention of Money Laundering Act" are underway and will be published by the end of August.

Through the medium of this great institution, let us try and create an ongoing cycle of learning-teaching-contributing! Let us remember *"Ex nihilo nihil fit"* and together strive to make an impact, to bring about a change and to see a new dawn!

Gratias tibi.

HINESH R. DOSHI
President

CA Khurshed Pastakia

Audit Documentation and Quality Control

The Expectation Gap

To begin with, one needs to appreciate that we live and work in a dynamic, ever-changing environment. What used to be, is replaced by something else today, and will be replaced again by something different tomorrow. To be a successful professional under these circumstances, one needs to be quick on his feet to embrace and master change. This is particularly true of the profession of auditors, because they directly report to this constantly transforming society.

We, auditors, sometimes tend to believe that our "client" is the entity that appoints us to perform an audit because it pays us our fees. This is wrong. Our true client is the society, the people who use our reports to make their financial decisions. It is this society that we serve and are primarily answerable to. To succeed in our profession, we must live up to and even exceed the expectations of those whom we serve. It is therefore important for an auditor to first know what those expectations are. These expectations cannot be found in auditing textbooks. They are to be gathered from what is going on around the world and in our own country. Changing micro and macro economic factors, changing ways of doing business including new types of businesses, changing corporate governance, changing accounting and auditing standards, changing laws and regulations, changing political dispensations, changing technology, changing nature of information dissemination and media – all of these, and more, contribute to changing expectations.

If over the past decade auditors, as professionals, have come under scrutiny it is because there was, and still is, an "expectation gap" between what the society wants from an auditor and what the auditor is seen to be giving. The unfortunate reality is that society's expectations can be very high and auditors may not be able to fully satisfy them. For example, there is a blanket expectation that there should not be any fraud in an entity that has been audited. There is another expectation that an auditor must be a whistleblower and use his report or other means to warn of future sickness that might make an entity ill. Stickler auditors might simply say that these expectations are unrealistic, and therefore cannot be met. But there is a maxim that the "buyer is king". If chartered accountants cannot meet the society's expectations, the society might look elsewhere to get what it wants.

The more prudent and mature response from auditors would be to fully understand and sympathise with the reasons for the society's changing expectations, to modify our methods and procedures to the extent possible, and then to meet the expectations to the maximum extent possible. We would fail if we cling to the past and persist in doing what our fathers did.

Importance of Documentation

Given that the society's expectations are high and that, as a fraternity, we may find it difficult to meet all of them to the fullest extent, auditors should also seriously prepare "to defend" themselves. There are two aspects to this: one, is to "create" a body of sufficient appropriate evidence (yes, the same words that we use in audit) to prove that we have done all that we were expected to do in keeping with the letter and spirit of the accounting and auditing pronouncements of our Institute, and the prevailing laws and regulations; and two, is to make our audit work as rock-solid as possible so that it can stand up to any regulatory or law enforcement scrutiny or investigation.

When we talk of "audit documentation" as a means of creating the sufficient appropriate evidence required to defend ourselves, it needs to be recognised that creating documentation is entirely a matter of an auditor's choice. There are specific paragraphs in a number of auditing standards (hereafter referred to as "SAs") that *mandate* a certain minimum amount of documentation that needs to exist in an auditor's workpapers file. SA 230 deals entirely with the nature, timing and extent of audit documentation. It is a question that, if documentation mandated by Standards on Auditing is absent, can an audit be said to have been conducted "in accordance with the Standards on Auditing", as we assert in our auditor's report? Put differently, in the absence of the mandatory documentation can an auditor "prove" (in, say, a tribunal or a court of law) that he conducted the audit in accordance with the Standards on Auditing? Best practice, of course, expects auditors to go much beyond what is the mandatory minimum.

Besides being a compliance matter, in terms of the requirements of auditing standards, does documentation have any other positives? There are several:

- An audit, particularly of a mid-sized or large entity, is a "project" that an audit partner undertakes over a sustained period of time that involves: ensuring ethics and independence of the engagement team and of the firm, determining materiality and audit risks at different levels, planning and executing responses to those risks, performing tests of internal controls over financial reporting and substantive procedures, evaluating the impact of known and likely misstatements, developing conclusions on contentious matters, forming an audit opinion based on all of the above, and performing post-audit procedures. This project could also involve managing the work of specialists, working with joint auditors, dealing with service organisation auditors, etc. Such a project cannot be managed without maintaining detailed workpapers and documentation at each stage.
- SA 220, Quality Control for an Audit of Financial Statements, requires an engagement partner to take responsibility for reviewing workpapers and satisfying himself that sufficient appropriate audit evidence was obtained to support the conclusions reached. If the workpapers are deficient or incomplete, what would the engagement partner "review"?
- Documentation also enables the engagement partner to hold members of an engagement team accountable for the work they have performed.
- A large amount of information from one audit period is useful for the following period's audit. If workpapers are prepared

electronically, this "roll-forward" becomes very easy to do.

- SQC 1, Standard on Quality Control, requires performance of an Engagement Quality Control Review by a second partner or other competent professional. In addition, there could be inspections by the Peer Review Board or the Quality Review Board, and, in future, perhaps even by NFRA. These require an audit file to speak for itself.

SA 230, Audit Documentation

Per SA 230, documentation includes (a) a record of audit procedures performed, (b) relevant audit evidence obtained, and (c) conclusions the auditor reached. Before recording the audit procedures performed, an auditor needs to document the steps he undertook to plan the audit, assess risks, evaluate internal controls and come to a conclusion about what substantive audit procedures are appropriate in the circumstances and why. He also needs to maintain a full record of how he selected samples, what evidence he saw and why he considered it to be sufficient and appropriate. In areas of fraud risk such as management override of internal controls, unusual journal entries and accounting estimates, he needs to be able to demonstrate compliance with procedures laid down in SA 240. And finally, he needs to document how he accumulated and evaluated the errors that he found during testing, their likely impact on the untested portion of the population, and how he reached a conclusion that got reflected in his audit opinion.

Some of the key features of the standard are discussed below:

(a) Documentation needs to be prepared "timely". This means that as soon as each task is done, it should get documented and reviewed by an appropriate senior auditor. Documentation should, in other words, never become a post-audit exercise.

(b) The standard introduces the concept of an "experienced auditor". He is a hypothetical individual who has considerable practical experience and a reasonable understanding of audit processes; standards, laws and pronouncements; is aware of the entity's business environment; and knows the auditing and financial reporting issues relevant to the entity's industry. The standard says that an auditor shall prepare documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand the work done. This, in short, means that workpapers should be able ***to stand on their own feet*** and provide a full, detailed history of the audit to a complete stranger. Review by an experienced auditor who, after an unbiased perusal of the audit workpapers, is able to reach the same conclusion as the engagement partner, is thus the benchmark that regulators or courts would use to form a judgment on whether the auditor planned and performed the audit as expected to meet the requirements of standards, laws and regulations.

(c) The form, content and extent of documentation depend upon the size and complexity of the entity being audited. The larger the size and more the complexity, there would be more to document. This may bring some relief to SME auditors.

(d) The nature of audit procedures performed would invariably determine the kind of documentation required. The more detailed and complex the audit procedures, the documentation for them would also have to be more precise.

(e) The nature and extent of documentation would also depend on the kind of risk being addressed. If the audit procedure is to address a significant risk, including a risk of fraud, then the extent of

documentation would have to be far more robust than if the risk being addressed was a normal risk.

(f) If the auditor is able to obtain sufficient appropriate evidence, both quantitatively and qualitatively, documentation thereof should be quite straightforward. But if the audit evidence is inadequate, or incomplete, or non-existent, or in other ways weak, then the auditor would need to provide all the details of the evidence that was available, why he considered it to be lacking, and what alternative measures he took in order to obtain audit assurance. And, if he was not comfortable, how he considered or did not consider this in the auditor's report.

(g) Oral evidence, provided by the client in response to an auditor's queries, should be strengthened by being minuted and such minutes signed by the responding client personnel, who should be of a responsible and relevant designation. On top of this, the auditor should document how he corroborated the oral responses of the client by performing complementary checks. The cardinal auditing principle is that just "inquiry is not enough".

(h) When performing controls testing or substantive analytical testing the auditor may come across deviations from his expectation. He would then have to describe in the documentation what further audit procedures he performed, their results, and whether such further procedures helped to reduce the deviation to within tolerance limits. And, if not, how he reached his conclusions.

(i) When using an expert, the auditor would need to document how he concluded on the competence and independence of the expert, what data was provided to him, what were the scope and terms of reference for the work given to him, how the auditor reviewed the expert's work, what conclusions he drew from the expert's report, and if additional procedures had to be performed thereafter, documentation of that as well.

(j) The standard clarifies that documentation includes electronic documentation, in addition to paper.

(k) The standard also requires that superseded drafts of workpapers should not be retained among the audit workpapers.

(l) Documentation has to be in writing, printed or in electronic form. ***Oral explanations by an auditor are not acceptable as documentation, which means that unless work performed has been documented the inference is that it is not done.*** Oral explanations, however, can support or explain something that is already properly documented if need be in inspection or investigation by regulators or law enforcement.

(m) Apart from the direct requirements of SA 230, it should also be remembered that the SAs require an auditor to do many things before, during and after the course of the audit. For example, an auditor has to plan an audit, he has to agree the terms of engagement with the client, he has to demonstrate enhanced professional skepticism where there is significant risk, he has to review the work of his assistants, etc. The auditor may do all of these, but until he has documented details of how and when he did them, there would be nothing to show that he followed those requirements of the SAs.

(n) There are also several other matters in SA 230 such as significant documentation matters, file assembly and archival, ownership of workpapers, matters arising after the date of the auditor's report, etc.

Documentation Requirements of Other Standards

Apart from SA 230, which applies to all situations, ***there are SA-specific documentation requirements in as many as 13 ASs, 3 SREs and 2 SRSs.*** All of these need to be carefully complied with because, otherwise, it would not be possible for an auditor to establish that he complied with that particular pronouncement.

Detailed Guidance on Documentation

For more detailed discussion and guidance on audit documentation, refer the book, "Evidencing Your Audit", published by Wolters Kluwer (CCH),.The book deals in depth with the subject in 23 chapters, including on documentation with reference to "Key Audit Matters and Going Concern under SA 701".

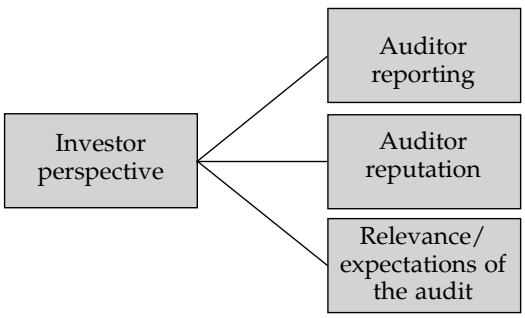
What Audit Quality Means to Stakeholders[1]

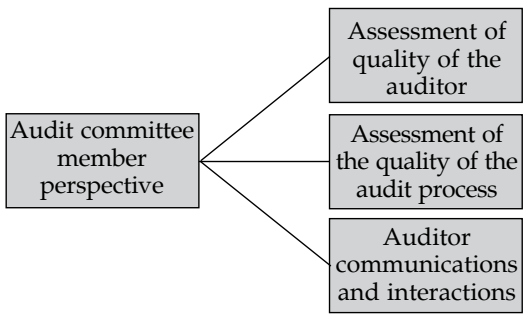
As our turbulent world moves from one global crisis to another (are we probably looking at the threat of a global trade war, even as we read this?), the criticality of credible, high-quality financial reporting gets heightened. Audit quality is one component of quality financial reporting, and depends on the integrity of each of the other components that link the financial reporting supply chain.

External audit is an activity of significant public interest with stakeholders across capital markets, public sector, private sector and the government. Standards on quality control and standards on auditing are only one of several components influencing audit quality. Other components include user perceptions, skills and competencies of auditors, the actions of others in the financial reporting supply chain, and the legal, regulatory and business environments.

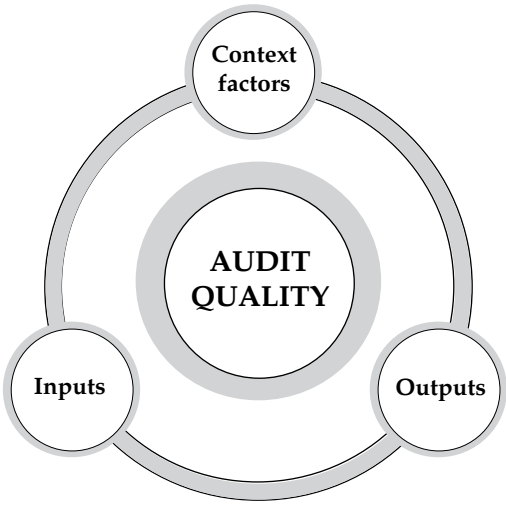
The context in which we perform audits is continually changing to keep pace with changes in the business environment, reporting standards, regulation and technology. Audit, therefore, is a continuously evolving activity. Audit quality is consequently not a fixed program with a stated outcome. It is a process that evolves with time.

So, what is audit quality? Different stakeholders have different perceptions. Some examples may be seen in these diagrams.





1 This section has adapted from an IAASB publication



Audit quality may conceptually be viewed in terms of three aspects: inputs, outputs and context factors.

Apart from auditing standards, there are two main ***inputs***: One, the auditor's personal attributes such as his skill, experience, ethical values and mindset. Two, the audit process – that is, the soundness of audit methodology, the effectiveness of the audit tools used, and the availability of adequate technical support.

Outputs of the audit also influence audit quality, for example where the auditor's report clearly conveys the outcome of the audit, it is viewed as positively impacting audit quality. Another is the auditor's meaningful communication with TCWG on matters of the entity's internal controls and financial reporting practices.

An example of ***context factors*** that influence audit quality would be sound corporate governance in a climate of transparency and ethical behaviour within the entity. Laws and regulations that create a framework for effective conduct of audits, an effective regulatory oversight that monitors an auditor's quality of work, and use of a financial reporting framework that promotes robust and transparent disclosures are other context factors.

Audit quality is not just about compliance or a desire to somehow meet requirements. It requires an auditor to have a positive "mindset" that takes professional pride in doing a great audit. Compliance with standards in their true spirit is an integral and sacred part of that mindset, but audit quality goes far beyond that. Its aim is to exceed the expectations of all the stakeholders who use the results of audit with the highest levels of ethics and integrity. It is the only way in which we, as a profession, can regain the confidence of society in the value of the work that we do. Only when society perceives this value, its respect for chartered accountants as auditors will be restored.

ICAI's Audit Quality Framework (SA 220 and SQC 1)

The audit quality framework that is established by the ICAI comprises primarily of SA 220 and SQC 1, at the audit engagement level and the audit firm level respectively.

There is a considerable amount of overlap between these two standards although both of them became effective in India only within a year of each other. To avoid repetition, for our continuing discussion we shall focus on SQC 1, which is the more comprehensive of the two standards. However, every audit professional who is a part of an audit engagement team, also needs to be well aware of the requirements of SA 220 before the start of the audit.

SQC 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information & Related Services Engagements

The ICAI, in promulgating SQC 1, has recognised that it is not just individual members of an audit engagement team who are responsible for the audit, but in fact the whole firm of which they are a part. It is the firm that provides the leadership, framework, direction, methodology and infrastructure that guide and instruct its partners and professionals on how to perform audits. It may be observed that, in addition to the partners and professionals who participated in the audit, their firms are being held equally responsible for audit failures by regulators across the world including, increasingly, in India.

SQC 1 requires audit firms to put in place and implement formal policies and procedures around the following six inter-related elements

- Leadership responsibilities for quality within the firm
- Ethical requirements
- Acceptance and continuance of client relationships and individual engagements
- Human resources
- Engagement performance
- Monitoring

While the standard gives the areas in which firm-level policies and procedures are to be installed and implemented, it does not provide any further detailed guidance on how the firms would actually frame those policies and procedures, leaving that to the judgment of individual firms. The Audit & Assurance Standards Board of the ICAI recognised this, and has published an exhaustive ***"Implementation Guide to SQC 1"***. This is an Institute publication that will be of invaluable use to small audit firms that do not have the resources to build up the entire SQC 1 structure from ground up.

What this *Implementation Guide* does is provide practical suggestions on how a firm may actually develop the policies and procedures as required under each of the six elements. In difficult areas, the *Implementation Guide* has also provided ***illustrative templates*** that a small firm could simply copy and adopt, with some amount of tailoring if needed to suit its requirements. Six such Annexures are provided:

(a) Illustrative Annual Firm Independence Confirmation (Element 2)

(b) Illustrative Independence Policies (Element 2)

(c) Illustrative Client / Engagement Acceptance & Continuance Form (Element 3)

(d) Illustrative Engagement Planning Memorandum (Element 5)

(e) Illustrative Engagement Summary Memorandum (Element 5)

(f) Illustrative Firm Quality Control Checklist (Element 6)

Compliance with SQC 1 is indeed considered to be a challenge for SME auditors for the reason that traditionally they have not installed such formal structures of firm management and now find themselves at default. Many firms still resist implementing the internal controls that SQC 1 mandates, either out of ignorance (many have not even read SQC 1) or out of uneasiness that it may put them in a straightjacket and rob them of the freedom to conduct their practice the way they have been doing. Clinging to the past and resisting change is a negative approach. Given the increasing risks that our profession is facing, a strong regime of internal controls installed at the firm level will only safeguard auditors in the future. ***It is urged that SME auditors make the fullest use of the "Implementation Guide to SQC 1" – which has been designed keeping them in view – to set up and implement formal structures of internal controls, both in letter and spirit.***

We will now briefly discuss some of the broad features of SQC 1 under each of the six elements:

1. Leadership responsibilities for audit quality within the firm

For any professional, be he a doctor, lawyer, architect or auditor, the work that he produces or the service that he renders is always measured against the yardstick of *quality*. Would we go to a doctor who has a poor reputation of curing patients, or would we go to one well-known for his cures? Would we buy a flat in a building constructed by a builder whose previous construction developed leaks and cracks, or would we go to a builder whose quality of construction was guaranteed? Would we entrust our sensitive litigation to a lawyer walking down the street, or would we pay more and go to a lawyer of known skills in winning cases? The answers are obvious. A professional lives by his reputation, and his reputation is built largely by the *quality* of his work.

An audit is not done solely by the signing partner, but by a team of people who assist and support him. All members of that team, and not he alone, need to

possess and contribute to *audit quality*. In a firm there may be several such signing partners and several teams of people assisting them. If all of them are to be held to the same level of *audit quality*, they need guidance on what is expected of them. Such guidance comes in the shape of SQC 1 quality controls that are set by the firm leadership and implemented uniformly across the firm by all audit partners and professionals.

A firm's leadership usually comprises of the managing partner (MP) and a small group of senior partners. For our purpose we shall refer to firm leadership as "MP". It is the MP who sets and monitors what is popularly called ***"The Tone at the Top"***. In any organisation, if the Tone at the Top exudes *quality*, the entire organisation follows *quality*. And the reverse is equally true. A message needs to go down the line that in our firm *audit quality* is all-important, that *quality* shall be rewarded and a lack of *quality* punished. Importantly, the MP should practice what he preaches, because his juniors look up to him and keenly watch his every action. If the MP slips on *quality* even in one instance, people will notice it, and that will set a bad example. On the other hand, if they observe him putting into practicing a high level of *quality* in every circumstance, he will be their "*quality hero*", who they will all emulate.

2. Ethical requirements

A large number of stakeholders rely on contents of the finished product of an audit viz., the auditor's report. Why do they so rely? Because they ***"trust"*** an auditor to bring to their notice, through his report, any existing or latent sickness or deformity in the entity that he has audited. These stakeholders are putting their money or careers on the line when they ***"trust"*** an auditor. The success or failure of our firms as well as of our profession rests totally on the ***public perception*** of whether an auditor is trustworthy. And ***the building block of that trust is ethics***.

Ethics include: integrity, objectivity, professional competence, due care, confidentiality and professional behaviour. Our Institute has a written Code of Ethics. However, ethical behaviour is never compliance with a rulebook. It is a human quality that flows from our character.

Another integral part of ethics is auditor independence. As a profession we are in a most peculiar situation: we issue reports that could be critical of the very entity that pays us. It is natural for outsiders to think that, since we accept our remuneration from an entity, we might favour that entity and not report honestly. That perception should be overcome if we want to regain the Society's trust. This ***trust***, as we have seen above, is the hinge of our survival. ***We, therefore, must not only be independent of our auditees but also be "seen to be independent".***

SQC 1 requires an auditor's firm to have a written Independence Policy which needs to be implemented and regularly monitored. For SME auditors, ***Annexure II to the Implementation Guide*** provides a model set of Independence Policies that they may choose to adopt. These Policies are built on the *"threats and safeguards"* approach, which identifies threats to independence, on the one hand, and the safeguards that a firm may take to mitigate those threats.

Five such threats are identified:

i. *Self-interest threat:* The threat that an auditor having a non-audit relationship with his client may have a conflict of interest. For example, if the auditor owns shares in the auditee company, or has taken or given a loan, etc., would have a personal financial interest that could overwhelm his professional independence.

ii. *Self-review threat:* If an auditor has provided or is simultaneously providing certain accounting or non-audit services to an auditee, his opinion may be clouded to that extent. For example, if an auditor has provided a valuation report to his client and the said valuation is used in the accounts that he audits, there would be a clear conflict of interest.

iii. *Advocacy threat:* The threat that arises when an auditor promotes (or appears to promote) a client's stand. For example, when an auditor acts as a tax representative and fights the client's tax case in a Tribunal on his instructions and behalf.

iv. *Familiarity threat:* Where an auditor has relationship with his client outside of what is

purely professional he would be seen to lack independence. For example, if the auditor's son or daughter is employed with the auditee in a senior position, or where an auditor accepts a valuable gift from his auditee client.

v. *Intimidation threat*: This threat arises when an auditor is deterred from acting freely and objectively, with an adequate degree of professional skepticism. For example, where a large proportion of his income comes from one auditee (or group), it would give a lever to the auditee to apply pressure on him to report in a particular way.

Each of these threats has to be recognised and evaluated by the firm. If it is possible to apply safeguards to mitigate the risk from a threat, the firm should make a policy to install that safeguard. However, where a safeguard would not mitigate the risk, the auditor has to establish a mechanism to exit from all or the audit portion of services that he has offered to the entity. For SME auditors, ***Annexure I to the Implementation Guide*** also provides a template of an Annual Firm Independence Confirmation.

3. Acceptance and continuation of client relationships and specific engagements

As has been said above, an auditor's professional existence hinges on his reputation. Reputation is entirely a perception concept. It is what others think of us. Except by constant demonstration of one's ethics and integrity, it is impossible to influence what others think of us. There are no rules or filings or compliances by which one can safeguard his reputation. Warren Buffet famously said: "It takes 20 years to build a reputation, and five minutes to ruin it. If you think about that, you'll do things differently."

Who we associate with, or the nature of work we do, directly influences what people think of us. George Washington had said: "Associate with men of good quality if you esteem your own reputation; for it is better to be alone than in bad company." We therefore need to spend a good amount of our time and effort in selecting our clients to ensure that their disrepute or disgrace in the marketplace, if any, does not rub off directly or indirectly on us. Just as our clients choose us for our reputation, we must choose our clients for their reputation. A firm should therefore put in place policies around how it should choose to work with existing and new clients, and what kind of engagements it should or should not accept or continue. **Annexure III to the *Implementation Guide*** gives a sample Client/ Engagement Acceptance and Continuation Form that SME auditors may adopt.

4. Human resources

Being part of the knowledge industry, an audit firm's greatest asset is its people. The skills, personality, integrity, objectivity, technical competence, knowledge, experience, and commitment of its partners and professionals is what makes a firm what it is. People, by their very nature, are complex and must be handled evenly and with fairness. It is also important for the MP to ensure that his people are adequately motivated to perform their best for the firm.

SQC 1 therefore, requires a firm to lay down proper HR policies that deal with recruitment, performance evaluation, capabilities, competence, career development and growth, promotion, compensation and the personal needs of partners, professionals and support staff.

5. Engagement performance

While all the other elements of SQC 1 are important, to my mind, the most important element is Engagement Performance: How do a firm's partners and professionals actually perform audits?

If we look at the Objective of the System of Quality Control in SQC 1, it is: *"to provide the firm with reasonable assurance that its personnel comply with applicable professional standards as well as the regulatory and legal requirements, and that reports issued by the firm or engagement partners are appropriate in the circumstances."* How does the MP get that assurance? If he leaves things to the discretion of every partner and professional, audits will be planned and performed in a completely haphazard and disorganized way, and the firm's audit practice would really be quite directionless. It is therefore most important for the MP to set standard practices and procedures that uniformly

apply to all audits done in order that *audit quality* is consistently maintained.

These policies would be around pre-planning activities, audit planning and risk assessment activities, developing adequate responses to audit risk, determining materiality, selecting samples, using checklists and pre-drafted templates, collecting sufficient appropriate audit evidence – particularly in instances where there are managment judgements and estimates used, evaluating known and likely misstatements, review of workpapers, framing auditor's reports – including the matters related to giving modified reports, documentation and building up workpaper files, etc. As can be guessed, compliance with this element of SQC 1 will require not only time and effort, but also a great deal of foresight and judgment on part of the MP. It will also require a huge change in the mindsets of senior partners and professionals who have had the freedom and been used to a particular way of working until now.

For SME auditors, ***Annexures IV and V to the Implementation Guide*** have given two very exhaustive documents: an Illustrative Engagement Planning Memorandum and an Illustrative Engagement Summary Memorandum. These need to be filled before and after audit fieldwork respectively.

6. Monitoring

Once policies and procedures are set up and implemented for the first time, the MP will encounter a lot of teething troubles. This is not because the policies and procedures are hard to follow but because the partners and professionals will most likely resist change. People will tend to follow the new policies and procedures in letter rather than spirit – going to a tick-in-the-box approach. It will take some expert manoeuvring on part of the MP to get everyone on the same table and ensure that Quality Controls are properly implemented.

One of the ways is to set up a monitoring mechanism whereby adherence to audit quality is periodically checked and those found wanting are properly advised. SQC 1 also requires policies and procedures to be drawn up for establishing such a monitoring mechanism, which includes the Engagement Quality Control Review or EQCR as well as reviews of Independence, etc. For SME auditors, ***Annexure VI to the Implementation Guide*** has provided an Illustrative Firm Quality Control Checklist that they may adopt.

Concluding words on Documentation and Quality Control

The overarching theme that has driven the above discussion is the current surrounding in which we, auditors, are situated: a surrounding where the trust of society on auditors has got slightly dented. It is imperative that, as professionals, we must take every step we can to restore that trust to the fullest. We have to do this in two ways, attack and defence. When one says attack, it means we must look inwards and overcome the lethargy or laissez-faire attitude within us by improving and controlling the quality of our professional work at all levels. This begins with becoming knowledgeable about the auditing pronouncements, laws and regulations and having the will to excel. When one says defence, it means we must take all steps possible, including detailed documentation, to build up a body of evidence that could come to our rescue in case we are challenged by regulators or law enforcement agencies.

It would be a folly for SME auditors to assume that frauds happen only in the big companies that are audited by the big auditors, and that they are therefore immune from the threat of regulatory or law enforcement action. The fact is that larger firms have at least some resources with which to combat such action, if it ever unfortunately falls upon them. Smaller firms would lack that. ***To help SME auditors, we have listed above two books that could help them set up the documentation and quality control structures respectively in their audit practices.*** Apart from this, they may even think of hiring the services of outside experts (other more experienced auditors or retired partners of larger firms) who may have the experience in designing standard documentation and quality control policies and procedures.

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CA Zubin Billimoria

Documentation and Communication related Standards on Auditing

Introduction

Meaning of Audit Documentation

Whilst the concept of audit is well-known and understood by the professionals and other stakeholders, what is more often than not ignored and in many cases at great peril, is the documentation of the audit, especially with regard to the statutory audits conducted for various entities.

The basic framework for the audit procedures and documentation thereof is laid down in the Standards of Auditing (SAs) issued by the Institute of Chartered Accountants of India. Whilst initially they were morally binding only on the practitioners, with the enactment of the Companies Act, 2013, they have been made mandatory under Section 143(10) of the said Act and they now have statutory force and support.

In common parlance, the term audit documentation refers to the **working papers prepared or obtained** by the auditor and retained by him, in connection with the performance of his audit. The basic principles on audit documentation are laid down in **SA-230 on Audit Documentation**. Further, specific requirements related to audit documentation are also laid down in other SAs.

More specifically, the term audit documentation is defined in SA-230 as *a record of audit procedures performed, relevant audit evidence obtained, and conclusions the auditor has reached. (Terms such as "working papers" or "workpapers" or "**audit file**" are also sometimes used interchangeably with audit documentation).* An **Audit file** in the context of audit documentation refers to *one or more folders or other storage media, in **physical or electronic form**, containing the records that comprise the audit documentation for a **specific engagement.***

General Considerations Governing Audit Documentation

Documentation is all pervasive in an audit and compliance with all SAs need to be adequately and appropriately documented to support the audit opinion. With the quality of audit work getting increasingly questioned, documentation is the only way for an auditor to substantiate that he was not negligent, in the event of legal and / or disciplinary proceedings.

SA-230 lays down that the auditor shall prepare audit documentation that is sufficient to **enable an *experienced auditor*** *(defined below)*, **having no previous connection with the audit**, to understand:

- audit procedures performed;
- relevant audit evidence obtained; and
- conclusions reached.

In the context of the above requirements, the term ***experienced auditor*** *refers to an individual (whether internal or external to the firm) who has practical audit experience, and a reasonable understanding of the following matters:*

(i) *Audit processes;*

(ii) *SAs and applicable legal and regulatory requirements; and*

(iii) *The business environment in which the entity operates; and Auditing and financial reporting issues relevant to the entity's industry.*

The basic idea behind audit documentation is that an *audit file should be able to stand on its own in the event of being challenged by outside scrutiny whether legal or otherwise.*

Accordingly, the purpose and benefits of proper audit documentation can be summarised hereunder:

- It assists the audit team in planning and performing the audit.
- It provides a record on matters of continuing significance.
- It helps in creating accountability and fixing responsibility.
- It assists in in the supervision and direction of the audit engagement.

Let us now proceed to dig a little deeper into the various audit documentation standards including certain practical perspectives.

Overview of Audit Documentation Standards

As discussed above, SA-230 is the main standard dealing with audit documentation. In addition, there are **certain SAs which require mandatory documentation to be part of the audit work papers. Finally, there are specific documentation requirements laid down in various other SAs.**

A brief discussion on each of these aspects follows.

Basic Principles under SA-230 on Audit Documentation

Apart from defining audit documentation, as discussed above, SA-230 lays down the basic characteristics about the nature and content of the audit documentation.

The SA broadly provides that the auditors should record and document, ***whether manually or electronically,*** the following matters in connection with an audit:

- The identifying characteristics of the specific items tested.
- Who performed the audit work and the date on which the same was completed.
- Who reviewed the audit work performed and the date and extent of such review.
- Discussions of the significant matters with the management, those charged with governance and others.
- The nature of and the significant matters discussed, especially those which involve substantial judgments and estimates on the part of the Management.
- When and with whom such discussions took place.

- If some information is identified that is inconsistent with the auditor's conclusion, how was the inconsistency addressed.
- Recording of the audit plan.
- Nature, timing and extent of audit procedures performed.
- Working papers should have adequate audit evidence for assertions made in financial statements
- Working papers should agree with books of account, financials and are cross referenced.
- Conclusions drawn from the evidence obtained.

The following are some of the important factors which affect the form, content and nature of the audit documentation:

- Nature of engagement.
- Form of audit report.
- Nature/complexity of client's business.
- Nature/condition of client's records.
- Degree of reliance on internal controls.
- Need for direction, supervision and review of work done by assistants.

It is important that the auditor should ***assemble*** the documentation in an audit file within a ***reasonable time (generally 30 to 60 days)*** after the date of the auditors' report. Once the assembly is complete, it is not permissible to delete or discard audit documentation. If circumstances so required, some new audit documentation may be added after the assembly of the audit file, in which case, the auditor needs to document the specific reasons for making them and to record when and by whom they were made and reviewed. ***Further in case of electronic documents added precautions need to be maintained for the security and subsequent modification and retrieval. Finally, Standard on Quality Control (SQC) 1 issued by the ICAI provides that in all audit engagement related documentation should be preserved for a period sufficient to meet the needs as required by law or regulation. However, in the absence of specific legal or regulatory requirements, SQC-1 provides that the retention period should not ordinarily be shorter than seven years from the date of the auditor's report.***

Nature and Contents of Audit Documentation – Practical Perspectives

The audit documentation should be broadly structured on the following lines, irrespective of whether it is manual or electronic:

Permanent Audit File

An updated and relevant permanent file is of paramount importance in view of dynamic legal and regulatory requirements. Documents that transcend several audit periods are retained in a permanent file. The permanent file should contain only documents of continuing importance and it should be periodically updated to remain relevant.

If a permanent file is maintained electronically, it could be maintained separately or its contents could be moved in a separate section in the current audit file. In my view the former option is preferable. In the ultimate analysis, a balance needs to be struck between scanned copies and manual storage, especially in respect of sensitive client documents which are confidential, wherein only relevant extracts could be retained.

The recommended common contents of a permanent file can be broadly divided as under:

- **Know Your Client**
- **Accounting and Internal Controls**
- **Legal and Regulatory Matters**

Examples of documents / information under each of the above are as under:

Know Your Customer

- Nature of Business
- Promoters / shareholders / directors details
- Incorporation / statutory / regulatory registration details
- Shareholder agreements
- Group structure
- Related parties
- Other major stakeholders / consultants / bankers / lenders

Accounting and Internal Controls

- Last 3-5 years financial statements / annual reports
- Standard Operating procedures / System notes / process flow diagrams
- Risk Control Matrices for major business cycles
- Software / IT details
- Extracts of Board and other Committee meetings for last 3-5 years
- Significant audit issues for last 3-5 years
- Analytical review

Legal and Regulatory Matters

- Funding agreements
- Royalty / brand / technical know-how agreements
- Lease / licencing / title documents
- Labour agreements
- Tax returns / assessment orders / other similar documents

Current Audit Files

Current Audit Files represent the heart and soul of the audit documentation. It contains documentation of the **control and substantive procedures** as well as **other administrative matters** to comply with the specific regulatory, professional, operational and control aspects. It may be maintained both electronically or manually and in practice is a combination of both since certain original signed documents need to be retained at a bare minimum.

The following are some of the common contents in the current audit files:

- Appointment related documents
- Minute book extracts (carried forward from the permanent file plus those pertaining to the current year)
- Evidence of planning process and audit programmes
- Analysis of transactions and balances
- Record of nature, timing and extent of audit work performed the results thereof
- Evidence of supervision of assistants' work
- Communication with other auditors, experts and third parties (including IT specialists)
- Letters of representation/confirmation received from the Management
- Conclusions about significant audit issues, including how exceptions/unusual matters were resolved/treated
- Copies of financial information under report and related audit reports

The above are the broad requirements. Specific requirements under various SAs are discussed subsequently.

Mandatory Audit Documents

After having examined the basic documentation requirements under SA-230, it would be worthwhile to examine certain **mandatory**

documents which are required to be prepared in terms of certain SAs as indicated hereunder:

- SA-210 Agreeing the Terms of Audit Engagement **(Engagement Letter)**
- SA-300 Planning an Audit of Financial Statements **(Audit Planning Memorandum)**
- SA-580 Written Representations **(Letter of Representation)**

Let us now briefly examine the requirements in respect of each of the above.

Engagement Letter

SA-210 provides that it is in the interest of both the entity / client and the auditor that the auditor send out an engagement letter before the commencement of the audit to help avoid misunderstanding with respect to various aspects of the audit. Though the form and content of the engagement letter may vary for each entity, the SA recommends certain minimum requirements regarding the contents of the engagement letter, which are summarised hereunder:

- Elaboration of the scope, regulatory framework, ethical and professional pronouncements etc.
- Form and manner of communication
- Inherent limitations of an audit
- Respective responsibilities of the Management and the Auditors
- Arrangements for planning and performing the audit
- Expectation that management would provide representations and information (including any matters affecting financial statements) on timely basis
- Fees and billing arrangements
- Involvement of other auditors, internal auditors, predecessor auditor, component auditors etc.
- Working paper and confidentiality arrangements
- Possibility that the audit working papers and other client information would be shared during the course of peer/quality review of the audit firm

Practitioners are advised to refer to and as far as possible follow the example of an audit engagement letter which is included in Appendix I of SA-230, duly tailored to suit the specific client requirements including the requirements laid down by any laws or regulations such as Banks, NBFCs, Insurance companies, Mutual funds etc.

Consequent to the introduction of the separate requirement under the Companies Act, 2013 to issue a separate report on the adequacy of the design and the operating effectiveness of the Internal Financial Controls over Financial Reporting (IFCOFR), a question often arises as to whether a separate Engagement Letter needs to be issued or the same should be included as a part of the normal engagement letter issued pursuant to SA-210 discussed above. Whilst there are no definite answers to the same it would be worthwhile to note that the **Guidance Note on Reporting on Internal Financial Controls over Financial Reporting** issued by the ICAI ***recommends that a separate Engagement Letter should be issued in respect thereof and hence it is imperative that the auditors adhere to the same in view of the binding nature of the Guidance Notes as members of the ICAI.*** Also like in the case of SA-210, the Guidance Note also lays down a format as part of the Appendix. Finally, it is also recommended that the *main Engagement Letter makes a reference to this fact or alternatively the IFCOFR Engagement Letter is included as an appendix to the main Engagement Letter issued under SA-210.*

A question which often arises as to whether for recurring audit engagements (mainly in the context of the statutory audits conducted under the Companies Act) an Engagement Letter needs to be issued every year. In this context, para 13 of SA-210 provides that *on recurring audits, the auditor shall assess whether circumstances require the terms of the audit engagement to be revised and whether there is a need to remind the entity of the existing terms of the audit engagement. Further, para A27 of the said SA provides that the auditor may decide not to send a new audit engagement letter or other written agreement each period. However, the following factors may make it appropriate to revise the terms of the audit engagement or to remind the entity of existing terms:*

- *Any indication that the entity misunderstands the objective and scope of the audit.*
- *Any revised or special terms of the audit engagement.*
- *A recent change of senior management.*
- *A significant change in ownership.*
- *A significant change in nature or size of the entity's business.*
- *A change in legal or regulatory requirements.*
- *A change in the financial reporting framework adopted in the preparation of the financial statements.*
- *A change in other reporting requirements.*

Though the SA does not mandate an Engagement Letter to be issued each year, it is still a good practice to issue the same each year subsequent to the appointment so as to avoid ambiguity.

Audit Planning Memorandum

Like in any long term and recurring project, conducting and undertaking an audit involves a lot of planning and taking cognisance thereof, the ICAI has issued a separate SA-300 on Planning an Audit of Financial Statements. Whilst the detailed requirements of this SA are discussed in a separate article elsewhere in this issue, what is briefly discussed in this article are the documentation requirements relating to the audit planning process. Whilst the term Audit Planning Memorandum (APM) is not specifically referred to in the SA, it is so referred to by convention as a one stop comprehensive document of the entire planning process.

The SA requires the following matters to be documented in the APM:

- Documentation of overall audit strategy covering the scope, timing and conduct of the audit as also any changes in the same.
- Documentation of the audit plan covering the nature, timing and extent of risk assessment and other procedures at the assertion level in response to assessed risks.

The documentation of the above is based on assessments and evaluation of the specific documentation requirements under each of the following Standards, which are discussed subsequently:

- **SA-240 The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements**
- **SA-250 Consideration of Laws and Regulations in an Audit of Financial Statements**
- **SA-299 Responsibility of Joint Auditors**
- **SA-315 / 330: Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment and Auditor's Responses to the Assessed Risks**
- **SA-320 Materiality in Planning and Performing an Audit**

- **SA-402 Audit Considerations Relating to an Entity Using a Service Organisation**
- **SA-450 Evaluation of Misstatements Identified during the Audit**

Also, the detailed requirements, apart from the documentation aspects of each of these SAs are discussed in separate article(s) elsewhere in this issue.

Letter of Representation

The requirement to obtain a Letter of Representation stems from the requirement under SA-580 on Written Representation, which lays down that obtaining a written representation from the Management and those Charged with Governance is important and necessary to supplement the audit evidence used by the auditor in arriving at the conclusions on which the audit opinion is based. However, the SA reiterates that a written representation is no substitute for audit evidence to be obtained by performing other audit procedures and through other sources of audit evidence like inquiry, inspection, observation, analytical procedures, confirmation, re-performance and re-calculation.

The general contents of the Letter of Representation which are mandated by SA-580 are summarised hereunder:

- Acknowledgement of responsibility by the Management for preparation of financial statements in accordance with the relevant framework
- Affirmation from the Management that significant assumptions used in making estimates are reasonable
- Affirmation of the appropriateness of measurement process
- Disclosures are complete and appropriate
- No subsequent events require adjustment other than those disclosed in the financial statements
- **Provided access to and provision of all information including accounting records, results of risk assessment, frauds or suspected frauds etc.**
- Effects of **uncorrected misstatements**, both individually and in the aggregate are not material and inclusion of uncorrected misstatements as an **annexure**.

The Letter of Representation should be dated as near as practicable to but not after the date of the auditor's report on the financial statements and should preferably be signed by either the CEO, CFO, Chairman of the Audit Committee or any other signatory to the financial statements, as deemed appropriate.

After having discussed the mandatory audit documentation, let us now proceed to discuss the specific documentation requirements under certain other key SAs.

SA-240 – The Auditor's Responsibility to Consider Fraud and Error in an Audit of Financial Statements

The documentation requirements under the SA can be broadly summarised under the following headings.

Communication from the Management

- Management's communication to those charged with governance regarding its processes for identifying and responding to the risk of fraud.
- Management's communication to employees regarding its views on business practices and ethical behaviour.
- Representations from management and those who are charged with governance about their responsibility to design, implement and of maintenance of internal control to prevent and detect fraud, results of their assessment of risk and disclosure of fraud or suspected fraud affecting the entity.

Communication within the Audit Team

The SA provides for communication within the audit team on fraud related matters through minutes of discussions held covering the following matters:

- Procedures performed to demonstrate professional scepticism
- Unusual or unexpected variances arising out of analytical review procedures
- Fraud risks identified and mitigating procedures
- **Evaluation of the various Fraud Risk Factors as per Appendix I of SA-240.**

SA-250 Consideration of Laws and Regulations in an Audit of Financial Statements

The documentation requirements under the SA are briefly enumerated below:

- Representation from management that known non-compliances have been reported to the auditors.
- Auditors to document identified or suspected non-compliance with law or regulations, communication to the management and results of discussion with them covering the following matters, amongst others:
  - (i) Laws and regulations involved and the nature of the breach.
  - (ii) Is the breach regularised / rectified?
  - (iii) Is the breach material / significant?
  - (iv) Whether there was any external consultation both by the Management / auditor?
- Reporting of non-compliance to regulatory and enforcement authorities where material or mandated by law.

SA-299 Responsibility of Joint Auditors

The SA provides that the division of work among joint auditors as well as the areas of work to be covered by each of them should be adequately documented and preferably communicated to the entity, *either separately or through the Engagement Letter if the same is issued and signed jointly.*

SA-315 / 330: Identifying and Assessing the Risk of Material Misstatement through Understanding the Entity and its Environment and Auditor's Responses to the Assessed Risks

The SA requires that the auditor should document in the audit working papers, the following matters:

- Understanding of the entity and its environment
- The understanding obtained of the entity's accounting and internal control systems; and
- The assessment of control risk.

This understanding can be obtained through one or more of the following means:

- Inquiries with the Management and others
- Information available in public domain
- Analytical procedures
- Observation
- Past experience

Further, when control risk is assessed at less than high, the auditor would also document the basis for the conclusions.

SA-320 Materiality in Planning and Performing an Audit

The auditor should document the calculation of the materiality *vide* the following steps:

i. Benchmark Chosen (PBT, Revenue, Equity, Net Worth, Total Assets)

ii. Benchmark Balance

iii. % applied

iv. Calculated Materiality

v. Adjusted Materiality (after considering the qualitative factors considered below)

vi. Aggregate of anticipated uncorrected / undetected misstatements

vii. **Performance Materiality** [v-vi]

The qualitative factors which need to be documented whilst considering the materiality are as under:

i. Justification for choosing a particular benchmark (PBT for established profit making entities, revenue or total assets where profit is volatile, or loss for start up entities, equity for newly set up entity)

ii. Higher % applied when using PBT (normally 5%) and lower % applied when using other criteria (normally 1% to 3%)

iii. Factors considered in determining Performance Materiality for particular class of transactions, account balances and disclosures based on the nature and type of misstatements determined in earlier periods

The following are certain other considerations which need to be kept in mind whilst calculating the materiality:

- **Materiality needs to be set for the financial statements as a whole.**
- **Lower materiality may be set for certain account balances, class of transactions and disclosures due to regulatory, reporting and industry considerations.**
- **Materiality can be revised as the audit progresses.**

SA-402 – Audit Considerations Relating to an Entity Using a Service Organisation

The SA defines a service organisation as *a third party organisation or segment thereof which provides services to the user entity that are part of the information systems relevant to financial reporting*. The role of service organisations is important due to the recent tendency on the part of entities to outsource financing and accounting functions, amongst others.

It is imperative for the auditor to obtain an understanding of services provided through direct testing or reliance on reports and this is especially **important from the Internal control reporting perspective under Companies Act, 2013 and keeping in mind the requirements of SA-315 and 330.**

In case the auditor decides to place reliance on reports for understanding and relying on the internal controls he needs to assess the type of reports as under:

- Type 1 report (only covers design and description of controls)
- Type 2 report (covers both design and operating effectiveness of controls)

The relevance and competence of the certifying authority needs to be evaluated before placing reliance on the same and assessing the extent of testing to be undertaken.

SA-450 – Evaluation of Misstatements Identified during the Audit

It is almost impossible to visualise a situation whereby the auditor would not encounter any misstatements during the course of the audit. The type of misstatement which could be encountered during the audit could be *factual, judgmental or projected*. In the context of misstatements identified, the auditor needs to document the following matters:

- Accumulation of misstatements (other than those that are clearly trivial)
- Consideration of identified misstatements as audit progresses

- Communication and correction of misstatements
- Evaluating the effect of uncorrected misstatements
- Written representation from management that uncorrected misstatements are not material.)

Finally, the cumulative uncorrected misstatements always need to be linked with the materiality before signing off on the audit opinion.

AUDIT COMMUNICATION

Audit documentation and evidence gathering is considered incomplete without communicating the same to the entity. The recent frauds / scandals and other irregularities have heightened the focus on auditors and it is important that they communicate on a timely basis, all relevant matters so as to be absolved of negligence. This communication is normally to various personnel at different levels of management and those charged with governance, which includes either / or the CEO, CFO or the Audit Committee. Keeping this in mind, the ICAI has formulated the following two SAs which deal with communication:

- **SA-260 – Communication with Those Charged with Governance**
- **SA-265 – Communicating Deficiencies in Internal Control to Those Charged with Governance and Management**

Before proceeding further it would be worthwhile to examine the definition of the terms Management and Those Charged with Governance under SA-260 referred to above.

Management

Para 6(b) of SA-260 defines the term management as *the person(s) with executive responsibility for the conduct of the entity's operations. For some entities, management includes some or all of those charged with governance, for example, executive members of a governance board, or an owner-manager.*

Those Charged with Governance:

Para 6(a) of SA-260 defines the term those charged with governance as *the person(s) or organisation(s) (e.g., a corporate trustee) with responsibility for overseeing the strategic direction of the entity and obligations related to the accountability of the entity. This includes overseeing the financial reporting process. For some entities, those charged with governance may include management personnel, for example, executive members of a governance board of a private or public sector entity, or an owner-manager.*

Let us now proceed to briefly examine the specific communication requirements under the above SAs which can be broadly classified as:

- General Communication
- Communication of Deficiencies in Internal Control

General Communication

The general communication requirements are as under:

- Auditor's responsibilities in relation to Financial Statement Audit and Internal Control Evaluation
- Planned scope and timing of audit
- Significant findings (including difficulties encountered)
- Affirmation of Independence
- Modification of Opinion

Whilst the SA does not mandate any specific form of communication, it is preferable and strongly recommended that the communication is sent vide a specific letter or e-mail, especially in the case of public interest entities and the same is acknowledged and / or included as a part of the minutes of the Board or the Audit Committee where the financial statements are adopted.

Communication of Deficiencies in Internal Control

Before getting into the communication aspects, it is important to briefly understand the term deficiencies in internal control, especially from the point of view of SA-265 referred to above.

Deficiencies in internal controls can occur in the following two situations:

- The controls are designed, implemented or operated such that they are unable to prevent, detect or correct misstatements on a **timely basis i.e., Detective Controls**
- The controls necessary to prevent, detect and correct misstatements on a timely basis are **missing i.e. Preventive Controls**

The communication of any deficiency should be made on a timely basis to the appropriate level of management depending upon the magnitude and severity of the deficiency.

The following are some of the factors which need to be kept in mind whilst communicating significant deficiencies in internal control:

- Legal and regulatory requirements e.g. banks and NBFCs.
- Specific considerations for smaller and closely held entities where the communication could be less formal and detailed.
- Extent of details to be communicated is a matter of professional judgment and is dependent upon the nature, size and complexity, governance structure etc. of the entity.
- The possibility of Management override of controls is relevant when determining whom to communicate to independently like the Chairman of the Audit Committee for public interest entities.
- Oral communication is desirable for timely remedial action especially in case of smaller and closely held entities.
- Written communication is desirable where the deficiencies are more critical and significant or where there are legal and regulatory requirements. This could take the form of a **Management Letter.**
- The communication should be clear and concise and at the same time bring out the **implications and recommendations** and strike a balance between being overly critical and as a tool for **value add/business condition insight. Finally, appropriate caveats need to be included.**

CONCLUSION

The above discussion is just the tips of the ice bergs and mountains which the auditors are expected to surmount in these days, due to greater regulatory oversight and increasing activism and expectations from the shareholders as well as other stakeholders. In such an environment the only saving grace for auditors would be adequate, appropriate and timely documentation and communication. The ultimate test is ***what is not documented is not done!***

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The only remedy for bad habits is counter habits.

— Swami Vivekananda

CA Atul Shah

Planning related Standards on Auditing

The saying, "If you fail to plan, you plan to fail", might be coined for the military but it is equally applicable in auditing also. Planning of any activity gives an activity a direction, focuses attention on objectives and results, manages time and resources efficiently, makes it easier to deal with potential problems and changes and above all establishes a basis for teamwork.

SA 300: Planning an Audit of Financial Statements

The primary auditing standard which deals with audit planning is SA 300: *Planning an Audit of Financial Statements*. SA 300 deals with the auditor's responsibility to plan an audit of financial statements and it is framed in context of recurring audits. This standard also prescribes the additional considerations required for an initial audit engagement. This SA has been designed so as to achieve the benefits viz., a) appropriate attention to important areas of the audit; b) timely resolution of potential problems; c) proper management of the audit engagement so as to ensure effective and efficient performance; d) assisting in selection of engagement team members with desired levels of capabilities and competence so as to respond to anticipated risks and proper execution of the assignment; e) review of work of the team members; and f) co-ordinating work done by other auditors and experts.

Objective

The objective of SA 300 is to plan the audit considering size and complexity of the entity so that audit is performed in an effective manner. Planning is continual and iterative process. The Engagement Partner and key members of the engagement team are required to be involved in the audit planning as well as in discussion with audit team members.

Preliminary Engagement activities

Following preliminary activities are to be undertaken at the beginning of the current audit engagement:

a. Appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements need to be performed in accordance with SA 220: *Quality Control for an Audit of Financial Statements.* SA 220 mandates that the Engagement Partner shall satisfy himself that he has at his disposal appropriate

competence and capabilities to perform the audit engagement in accordance with professional standards and regulatory requirements and there are no issues with management integrity.

b. To evaluate ethical requirement compliance including independence in terms of SA 220.

c. To understand the terms of engagement and documenting the same in an audit engagement letter or other suitable form of contract in terms of SA 210: *Agreeing the Terms of Audit Engagements.*

Planning includes timing of certain activities and procedures that need to be completed prior to the performance of further audit procedures. Such matters would *inter alia* include procedures for identification and assessment of the risks of material misstatement. Such matters are:

- Performing analytical procedures and other procedures for risk assessment
- Obtaining general understanding of the legal and regulatory framework and the manner in which the entity is complying with
- Determination of materiality
- Involvement of experts

The auditor may discuss elements of planning with the entity's management to facilitate conduct of audit, however, such discussion should not be at a cost of compromising the effectiveness of audit.

Planning Activities

Planning activities broadly encompass

a. Development of overall audit strategy

b. Audit plan

c. Planning relating to modification of the audit strategy and / or the audit plan during the course of audit and

d. Direction, supervision and review of work of engagement team members.

Overall Audit strategy

Audit strategy sets the scope, timing and direction of the audit and guides the development of audit plan. In establishing the overall audit strategy, the auditor identifies the terms of the engagement and understand the scope and deliverables i.e., the reporting requirements. The auditor considers the results of preliminary engagement activities and knowledge gained on other similar engagements performed in earlier years. Based on professional judgment, the auditor also considers the factors that should influence direction of the engagement team's efforts. As a result of above processes, the auditor ascertains the nature, timing and extent of resources required to perform the engagement. Some of the other factors that are considered while developing the audit strategy are as under:

1. Financial reporting framework adopted in preparation of financial information
2. Industry specific reporting requirements mandated by industry regulators e.g. disclosures requirements mandated by Reserve Bank of India for Non-Banking Financial Companies
3. Number and locations of components are covered in the engagement
4. Effect of information technology – availability of data and use of computer assisted audit techniques
5. Availability of work of internal auditors and extent of reliance on such work

Audit Plan

An audit plan is more in detail than the overall audit strategy. It includes description of the following:

a. The nature and extent of planned risk assessment procedures, as determined under SA 315: *Identifying and Assessing the Risks of*

Material Misstatement through Understanding the Entity and its Environment

b. The nature, timing, and extent of planned further audit procedures at the relevant assertion level, as determined under SA 330: *The Auditor's Response to Assessed Risks*

c. Other planned audit procedures that are required to be carried out so that the engagement complies with SAs

Modification in Audit strategy / Audit plan

The development of the overall audit strategy and the detailed audit plan are not necessarily discrete or sequential processes. Since these are closely inter-related, the auditor updates and changes the overall audit strategy and audit plan, as necessary, during the course of the audit. Such modifications are necessitated due to various reasons including consideration of audit evidences obtained as a result of audit procedures, unexpected events, changes in conditions, material contradictions between audit evidence obtained through substantive procedures as compared to audit evidence obtained through test of controls.

Direction, supervision and review of work of engagement team members

The auditor plans the nature, timing and extent of direction and supervision of engagement team members and review of their work. The auditor considers size and complexity of the entity; outcome of procedures conducted to assess risk of material misstatement; and above all capabilities and competence of the individual team members involved in performing the audit and determines the nature of supervision and review of work done by the audit team members.

Documentation

- Documentation relating to the audit strategy generally includes record of the key decisions regarding scope, timing and conduct of the audit which were considered in framing the audit plan and communication of significant matters to the engagement team.
- Documentation of audit plan serves as a record of the proper planning of the audit procedures describing nature, timing, and extent of risk assessment procedures and further audit procedures at the relevant assertion level in response to the assessed risks. Such records also support that proper planning was carried out, reviewed and approved prior to their performance. The auditor generally uses standard audit programmes or audit completion checklists. These are often tailored to reflect the particular engagement circumstances.
- Any significant changes made during the audit engagement to the above and the reasons for the same also forms part of documentation.
- The importance of documentation in planning is second to none as work performed but not documented is as good as work not performed.

Additional considerations in initial engagement *vis-à-vis* recurring engagement

Auditor need to expand the planning activities in case of initial audit engagement because the auditor does not have previous experience with the entity. Additional consideration includes:

a. Unless prohibited by regulation, arrangements to be made with the predecessor auditor's to review their working papers

b. Audit procedure necessary to obtain sufficient appropriate audit evidence regarding opening balances in accordance with SA 510: *Initial audit Engagements – Opening Balances*

c. Procedure that may be required in terms of firm's Quality Control parameters relating to initial engagement

SA 315: Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment

Objectives and definitions

The objective is to identify and assess the risks of material misstatement, whether due to fraud or error, at the financial statement and assertion levels. This objective is achieved through understanding the entity and its environment, including the entity's internal control, thereby providing a basis for designing and implementing responses to the assessed risks of material misstatement. This helps the auditor in reducing the risk of material misstatement to an acceptably low level.

SA 315 *inter alia* defines the term "business risk" and "significant risk". Business risk as a risk resulting from significant conditions, events, circumstances, actions or inactions that could adversely affect an entity's ability to achieve its objectives and execute its strategies, or from the setting of inappropriate objectives and strategies. Significant risk is an identified and assessed risk of material misstatement that, in the auditor's judgment, requires special audit consideration.

Requirements of SA 315

- Auditor, to provide a basis for identification and assessment of risks of material misstatement at the financial statement and assertion levels, performs risk assessment procedures. These procedures include: Inquiries with management; Analytical Procedures; Observation and Inspection.
- Where auditor has performed other engagements with the entity, auditor considers whether information obtained is relevant for identifying the risk of material misstatement. If auditor intends to use his previous experiences with the entity, he determines whether changes have occurred since previous audit that may affect its relevance on current audit.
- The auditor obtains an understanding of industry in which entity operates. He also obtains understanding of regulatory and other external factors; selection and application of accounting policies; entity's objectives and strategies and related business risks; measurement and review of entity's financial performance; internal control.
- SA 315 sets out components of Internal control as 1) control environment within the entity; 2) entity's risk assessment process; 3) the information system, including related business processes, relevant to financial reporting, and communication; 4) control activities relevant to audit; and 5) monitoring of controls.
- Auditor is required to identify and assess risks of material misstatement at financial statement level and at assertion level for classes of transactions, account balances and disclosures.
- Auditors are required to relate identified risks to what can go wrong at assertion level. Based on the same, consider potential magnitude of risks in the context of financial statements and also consider the likelihood that risks could result in a material misstatement of financial statements
- Documentation under this SA should cover documentation relating to discussion among engagement team; key elements of understanding obtained; sources of information; risk assessment process; identified and assessed risks; evaluation of significant risks; risks evaluated for which substantive procedures done
- Auditor uses professional judgment to determine the extent of understanding required. Auditors primary consideration is whether the understanding that has been obtained is sufficient to meet the objective stated in the SA

- Obtaining an understanding of entity and its environment including entity's internal control is a continuous, dynamic process of gathering, updating and analyzing information throughout the audit.

SA 330: The Auditor's responses to Assessed Risks

SA 330 deals with the auditor's responsibility to design and implement responses to the assessed risk of material misstatement identified in accordance with SA 315.

Objectives and Definitions

The objective is to obtain sufficient appropriate audit evidence about the assessed risks of material misstatement, through designing and implementing appropriate responses to those risks.

SA 330 defines the terms "substantive procedure" and "test of controls".

Overall Responses

The auditor is required to design and implement overall responses to address the assessed risks of material misstatement at the financial statement level.

Audit Procedures

Nature, timing and the extent of the audit procedures are to be based on and are responsive to the assessed risk of material misstatement at the assertion level. In designing the audit procedure, the auditor is required to consider the reasons for the assessment given at the assertion level for each class of transactions, account balance and disclosure including:

a. Likelihood of material misstatement due to the particular characteristics of relevant inherent risk

b. Whether the risk assessment takes into account the relevant controls

Test of Controls

Controls have to be tested to confirm its operating effectiveness and sufficient appropriate audit evidence to be obtained when:

a. There is an expectation that the controls are operating effectively

b. Substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level

More persuasive audit evidence needs to be obtained when greater reliance is placed by the auditor on the control effectiveness.

Nature and Extent of Test of Controls

In designing and performing tests of controls, the auditor inquires to obtain audit evidence about the operating effectiveness of the controls including:

- Application of controls at relevant times during the audit period
- Consistency of its application
- By whom or by what means they were applied

Further the auditor determines whether the controls depends upon any other control and if necessary obtains the audit evidence of those indirect controls.

Timings of Controls Test

Test the controls for the particular time or throughout the period for which the auditor intends to rely on those controls related to risk assessment procedure

Interim Period

When auditor obtains audit evidence about control's operating effectiveness during an interim period, then:

- Check for significant changes to those controls subsequent to the interim period
- Obtain additional audit evidence for the remaining period

Use of Audit Evidence obtained in previous Audits

The auditor need to consider the length of the time period that may elapse before retesting a control and take into account the following:

- The effectiveness of other elements of internal control which *inter alia* includes risk assessment process
- The risk from the control characteristics – manual or automated
- Effectiveness of general IT-controls
- Control effectiveness and its application including nature and deviation in the application noted in previous audits and whether there are any personnel changes which may affect control application
- Whether lack of change in a particular control poses a risk due to changing circumstances
- Risk of material misstatement and the extent of reliance on the control
- Continuance relevance of evidence by inquiring for any significant changes in those controls subsequent to previous audits
- If no changes observed, the auditor should test the control atleast once in every third audit and some controls each audit to test effectively

Controls over Significant Risks

Any significant risk in auditor's opinion should be tested in the current period. During this process, the auditor evaluates whether there are any misstatements detected by substantive procedure indicates that the controls are not operated effectively. If there are deviations, the auditor should understand its potential consequences through specific inquiries and determine whether:

a. Test of controls that have been performed provide an appropriate basis for reliance

b. Additional tests are necessary

c. The potential risk of misstatement is to be addressed using substantive procedures

Substantive Procedures

Irrespective of assessed risk of material misstatement, substantive procedures for each material class of transaction, account balance and disclosure are to be performed. Based on the facts, the auditor is required to consider whether external confirmation procedures are to be performed as substantive procedures.

1. Substantive procedures related to financial statements closing process
    - Agreeing or reconciling the financial statements with the underlying accounting records; and
    - Examining material journal entries and other adjustments made in the course of preparation of financial statements
2. Substantive procedures responsive to significant risk are to be performed and procedures to include tests of details
3. Timing of substantive procedures
    - If substantive procedures are performed at interim date, then for the remaining period perform substantive procedures, combined with tests of intervening period controls. If that is sufficient, perform further substantive procedures only.

If misstatement that the auditor did not expect are detected at an interim date, then the nature, timing, and extent of substantive procedures for the remaining period needs to be modified.

Adequacy of Presentation and Disclosure

Audit procedures are to be performed to evaluate whether the overall presentation of the financial

statements, including related disclosures, is in accordance with the applicable financial reporting framework.

Sufficiency and Appropriateness of Audit Evidence

Before the conclusion of the audit, the auditor determines whether the audit procedures performed and audit evidence obtained are appropriate for the assessment of the risk of material misstatement at the assertion level. If conclusion is affirmative, the auditor concludes and forms an opinion. If the conclusion is not affirmative, the auditor attempts to obtain further audit evidence. If the auditor is unable to obtain sufficient appropriate audit evidence, he needs to express a qualified opinion or a disclaimer of opinion.

An auditor should consider all relevant evidence regardless of whether it appears to corroborate or to contradict the assertions

Documentation

- Overall response to address the assessed risk of material misstatement and the nature, timing, and extent of further audit procedures;
- Linkage of those procedures with the assessed risk at the assertion level, and
- The result of the audit procedure including conclusions for unclear ones

If the audit evidence about the operating effectiveness control obtained in previous audits is used by the auditor, such fact should be documented. Auditor's documentation should demonstrate that the financial statements agree to the accounting records.

SA 320: Materiality in Planning and performing an Audit

Materiality in the context of an Audit

- Information is material if its misstatement (i.e. omission or erroneous statement) could influence the economic decision of users taken on the basis of financial information.
- Judgment about materiality are made in the particular circumstances and depends on size and nature of a misstatement.

Requirements of SA 320

- Materiality is considered at:
    - o Planning stage – It is an initial calculation which gives an initial perspective to auditor about the areas to focus on
    - o Performance stage – Materiality level determined at planning stage is revisited as the audit progresses.
    - o Opinion stage – This is to check whether the aggregate impact of unadjusted differences in financial statements are material
- Auditor considers materiality at both the overall financial information level and in relation to individual account balances and classes of transaction
- Materiality also be influenced by other considerations, such as legal and regulatory requirements. Non-compliances with which may have a significant bearing on the financial information and consideration relating to individual account balances and relationships.
- The auditor needs to consider the possibility of misstatement of relatively small amount. However, cumulatively it could have material effect on the financial information.

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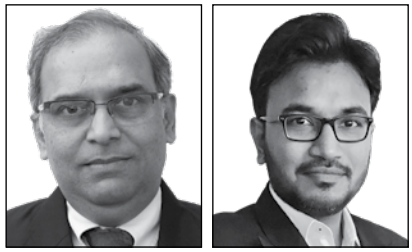

CA Vijay Maniar & CA Kulbhushan Gandhi

Risk Assessment and Internal Control Related Standards on Auditing

Introduction

This article outlines and explains the concept of audit risk and importance of the risk assessment standards and also how best to implement the risk assessment process. Also, making reference to the key auditing standards which give guidance to auditors about risk assessment through understanding the entity and its environment including entity's internal control.

Background

SA 315, Identifying and Assessing the Risk of Material Misstatement Through Understanding the Entity and its Environment, deals with the auditor's responsibility to identify and assess the risks of material misstatement in the financial statements, through understanding the entity and its environment, including the entity's internal control. SA 315, needs to be read with SA 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Standards on Auditing.

The standard defines Audit Risk as "The risk that the auditor expresses an inappropriate audit opinion when the financial statements are materially misstated. Audit risk is a function of the risks of material misstatement and detection risk". Accordingly, the Risk Assessment becomes very important for an auditor to reduce the audit risk to acceptably low level.

Risk assessment procedures includes:

- Inquiries of management and of others within the entity
- Analytical procedures
- Observation and inspection

Importance of risk assessment

One can refer to any published accounts of large companies and think about the vast number of transactions in Balance Sheet, Statement of Profit and Loss and related notes. It would not be feasible for auditors to check all of these transactions, hence the auditors should consider following risk based audit approach in order to minimise the chance of giving an inappropriate audit opinion.

While doing the risk assessment it is important for an auditor to understand the entity and its environment in order to conclude that the risks identified for an audit are adequate. Auditor should plan and perform an audit with professional scepticism, recognising that

circumstances might exist that may cause the financial statements to be materially misstated and hence risk assessment procedures are required in order to identify and assess the risks of material misstatement.

Simplifying the Risk Assessment Standards and Process

Significant risks have a special meaning within the risk assessment standards. They are defined in SA 315, as "an identified and assessed risk of material misstatement that, in the auditor's professional judgment, requires special audit consideration."

The audit plan / audit programme largely remains the same for most of the clients in terms of audit planning and nature, timing and extent of audit procedures, depending upon the nature and size of business / industry in which the business operates. Higher risk areas need special consideration or attention in terms of modifying the standardised audit plan so that it was responsive to those higher or significant risks. Area of higher risk varies from industry to industry e.g., retail industry, for billing, price of each item is picked from the price master and hence whether all changes in the price master are duly approved and authorised is a higher risk area, while for an EPC company the estimates and revenue recognition is higher risk area.

Further, for smaller and less complex audit client, if one has a good understanding of the audit client, its system of internal control, and the environment in which the client operates, do they really need voluminous checklists to be able to identify those areas of significant risks? The answer in normal circumstances is no.

The smaller firms who are trying to do different things, from tax planning and return preparation to helping their client with an assortment of business issues while trying to conduct an efficient and effective audit need to remember the importance of the risk assessment and its mitigation considering increasing compliances and expectation of various stakeholders.

Understanding the Business

Understanding of entity business is very important audit procedures in order to assess the audit risk. One needs to remember that even at client acceptance or at continuance process it is relevant to obtain sufficient information in order to identify risks of material misstatements.

The first risk assessment in any engagement is at the time of client acceptance level. Before auditor accepts a client it is essential to assess key client information such as:

- Background check of the entity including its holding company, material subsidiaries and its key managerial personnel
- Know your client requirements essentially prescribed by ICAI
- Nature, Size and Organisational Structures of Business
- Existing accounting policies along with assessment of immediately preceding year's financial statements
- Key stakeholders and their expectations
- Independence considerations

In understanding the business, we obtain an understanding of the entity and the environment in which it operates. This assists us in the identification of risk factors, if any. We determine whether these risk factors are inherent risks (i.e., risk factors that may give rise to risks of material misstatement) and consider the effect in combined risk assessments and in designing substantive procedures. In addition, we determine whether inherent risks that we identified in our understanding of the entity and its environment are significant risks.

We exercise professional judgment in determining the extent of understanding that is required. Our primary consideration is whether we have obtained sufficient understanding of the entity and its environment to identify and assess the risks of material misstatement at the financial statement

and assertion levels, whether due to fraud or error, and thereby providing a basis for designing and implementing audit procedures to respond to the assessed risks of material misstatement. As stated earlier, we obtain our understanding by performing review, inquiry, analytical procedures, observation and inspection.

The sources of information, in order to obtain understanding, can be internal to entity as well as external. Also, when auditor intends to use information gathered in his previous experience, one should assess whether there are any changes that have occurred since previous audit that may affect the risk assessment.

Internal factors mainly comprise of information and audit evidences available within the entity, viz.;

- Audited financials of the previous years
- Key contracts, documents which may impact the risk assessment of the engagement
- Documents related to the ownership of the entity, governance structure, organisation's structure and financing Operations (e.g., products and services manufactured and/ or sold)
- Key related parties and other stakeholders
- Key stakeholder influences
- Critical success factors
- Types of investments (e.g., acquisitions and disposals, special purpose vehicles)
- The entity's selection and application of accounting policies

External factors mainly are:

- Legal and regulatory framework including assessment of new or proposed regulation e.g., Goods and Services Tax, Real Estate Regulation and Development Act (RERA), even new IND AS 115 may have impact on risk assessment
- Industry outlook
- Competitors
- General economic conditions,
- Interest rates, availability of financing inflation or currency revaluation

Sometimes there are events or changes in regulations in foreign countries which may have direct impact on the risk assessment. Few examples which one can related to this:

- "Tariff War" between America and China i.e. among the world's largest economies, may have financial/operational impact on many entities in India.
- New General Data Protection Regulations (GDPR) in the European Union has direct impact on IT industry and entities who have material operations in EU
- Movement in oil prices
- Tax policy changes

Information obtained in prior periods is an important consideration. While performing the risk assessment one should always check the following:

- Are there any significant changes in the control environment
- Past misstatements and corrections thereof
- Changes in nature of entity and its environment and entity's internal controls
- Significant changes in entity and its operations since prior financial period

Many small audits are carried out entirely by the engagement partner (who may be a sole practitioner). In such situations, it is the engagement partner who, having personally conducted the planning of the audit, would be responsible for considering the risk of susceptibility of the entity's financial statements to material misstatement due to fraud or error.

One should always remember that an entity conducts its operations and business in the

context of industry, regulatory framework and as mentioned above internal and external factors. To respond to these, those charged with entity's governance define objectives, which are entity's overall plan. Strategies are framed to achieve those objectives. It is important for one to assess whether there is any change in the objectives or strategies and if yes, the same may have impact on the risk assessment and the audit procedures need to be modified to address those changes.

In certain cases Management Objectives may be influenced by concerns regarding public accountability and may include objectives which are affected by law, regulation and government directions.

Five components of internal control related to the entity

It is a specific requirement of SA 315 that the auditor obtains an understanding of the internal control relevant to the audit. This is a crucial step in assessing the risk of material misstatement, as one of the components of audit risk is control risk, defined as the risk that a misstatement that could occur will not be prevented, or detected and corrected, on a timely basis by the entity's internal control.

The COSO Framework is the foundation for understanding the clients' internal control system. As part of the audit process, auditors will have to assess how five components of internal control relate to the entity. Each of which must be understood and documented by the auditors.

In determining whether a control is relevant to the audit, matters such as the significance of the related risk, materiality, and the complexity of operations should be considered. Therefore the documentation of internal control should be commensurate with the nature, size and complexity of the entity.

In a smaller entity, the audit documentation on internal control is likely to be relatively simple, focusing on how sales and purchasing cycles operate and highlighting the risks of material misstatement that arise from the controls (or lack of) that are in place.

First element is control environment

Auditor obtains an understanding of the control environment component and its related elements (and principles when applicable), and obtain evidence that the elements are in operation.

The control environment is the foundation of the other internal control components. It reflects the overall attitude, awareness and actions of management, those charged with governance and owners, about the importance of controls and the emphasis placed on them in determining the entity's policies, processes and organisational structure. Further, it is a continuous, dynamic process of gathering, updating and analysing information throughout the audit.

It sets the tone of an organisation and provides discipline and structure, influencing the control consciousness of its people. Also it has a significant effect on the likelihood of fraudulent financial reporting and misappropriation of assets. It encompasses management's attitude towards accounting estimates, judgments and disclosures that are incorporated in the financial statements and, ultimately, its financial reporting philosophy. It is the context in which every control operates.

For example, within hotel group booking system technology has enabled hoteliers to finetune changes to pricing on an hourly basis, based on algorithms applied to large amounts of data about competitor prices. Auditors do not generally need to understand how prices are set, but they do need to understand the controls that ensure that the right price (i.e., one extracted from the correct file subject to various parameter checks) is being charged, because this information will be used in testing.

Another example is for a company holding a single leased asset with no indicators of impairment, management might use the lease contract as evidence of the assertions underlying the

disclosure of the asset in the financial statements. There may be no specific control relating to the asset other than management's knowledge and use of the lease contract. Auditor's documentation of the use of the contract as the control over that asset may be sufficient for risk assessment purposes. It may not be necessary to investigate more detailed control activities in this area.

We obtain an understanding of the control environment component and its related elements (and principles when applicable), and obtain evidence that the elements are in operation. The control environment is the foundation of the other internal control components. Below is the list of characteristics which is not intended to be complete, which one needs to assess while obtaining the control environment component and its related elements:

- Integrity, ethical values and behaviour of key executives
- Management's control consciousness and operating style
- Management's commitment to competence
- Participation in governance and oversight by those charged with governance
- The organisational structure and assignment of authority and responsibility
- HR policies and practices

Second element is entity's risk assessment process

Under this we obtain an understanding of management's risk assessment process, but are not required to obtain a more detailed understanding of the elements of the process. Entities, regardless of size, structure, nature or industry, encounter risks that may be external or internal to the organisation. The purpose of an entity's risk assessment process is to identify, analyse and manage risks that affect the entity's ability to achieve its objectives.

The entity's risk assessment process will vary depending on the size and complexity of the entity. For example in case of a listed entity, we expect that the entity would have a formal and documented risk assessment process, however in case of a less complex or promoter driven smaller entities the process of risk assessment may not be documented or formalised. Auditors need to use their knowledge and experience in these cases and take appropriate steps.

If the entity has not established a risk assessment process as explained above, or has an *ad hoc* process, one can do following procedures to document findings, those are:

- Inquire of management whether business risks relevant to financial reporting objectives have been identified and how they have been addressed.
- Evaluate whether the absence of a documented risk assessment process is appropriate in the circumstances.
- Determine whether the absence of a documented risk assessment process represents a significant deficiency (or material weakness if required to be communicated) in internal control.
- Accordingly, determine whether this gives rise to risks of material misstatement that are pervasive in the financial statements.

Third element is Information System

An entity's system of internal control contains manual elements and often contains automated elements. The characteristics of manual or automated elements are relevant to the auditor's risk assessment and further audit procedures based thereon.

Auditors are required to obtain an understanding of the information system, including the related business processes, relevant to financial reporting, including the following areas:

- the classes of transactions in the entity's operations that are significant to the financial statements;
- The procedures, within both IT and Manual systems by which transactions are initiated, recorded, processed, corrected, transferred to the general ledger and reported in the financial statements;
- the related accounting records, supporting information and specific accounts in the financial statements;
- how the information system captures events and conditions, other than transactions that are significant to the financial statements; and
- the financial reporting process used in preparing the entity's financial statements, including controls over significant accounting estimates and disclosures.

For a smaller, less complex entity, management and those charged with governance are likely to be the same body or person. Communication is likely to be informal and easily achieved due to fewer levels of responsibility and management's greater direct involvement with the operations of the entity.

Understanding obtained in prior audits and other audits of entities that use the same software accounting package can help auditors identify areas of risk that arise from the information system.

If auditors do not understand the system and assume that there are no controls relevant to the audit without further consideration, they write off the potential value of this work before they start. Operational and financial controls are often tightly integrated and interdependent.

For example, in case of a Company that is in business of movie theatre/or any other ticketing system controls over the issue of tickets are often linked with controls over the receipt of funds or the issue of invoices. This means that operational controls may sometimes be relevant to the audit and auditors need to think carefully about that and whether it is therefore necessary to assess their design and implementation. One way of determining this might be to ask whether the absence of the control might render the system inoperative, or vulnerable to the failure of a single control, or constitute a significant deficiency. For example, similar situation is there in toll collection companies, where the operational controls overlap financial controls and hence it becomes very important for an auditor to verify and obtain sufficient audit evidences in order to conclude on the operating effectiveness of such controls.

Further we also obtain an understanding of

a. Monitoring component (Fourth Element) and its related elements

   For this auditors are required to obtain an understanding of the major activities the entity uses to monitor internal control over financial reporting, including monitoring of relevant control activities. Auditors should also obtain understanding on how the entity initiates remedial actions to correct deficiencies in its controls.

   One can obtain their understanding of management's monitoring of controls by inquiry of management and inspection of items monitored such as completed bank reconciliations or balance confirmations. Evidence of changes made in prior years as a result of monitoring may also be relevant.

b. Communication component (Fifth Element) of internal control, but we are not required to obtain a more detailed understanding of the elements of this component. We obtain an understanding of how the entity communicates financial reporting roles and responsibilities and any matters that are significant to financial reporting.

   For non-complex entities, communication may be less formal due to the small number

of individuals involved in financial reporting and the greater the visibility of activities by management.

We consider communications regarding how an individual's roles and responsibilities relate to internal control over financial reporting, and how their role interrelates with the work of others. Such communications may be through policy manuals, financial reporting manuals, orally, through the actions of management and other written instructions. We also consider communications on how control exceptions and concerns over potential fraudulent activity are reported to an appropriate person in the entity.

Fraud Risk and its importance

We use professional judgment in determining whether a fraud risk factor is present. We determine fraud risk factors in the context of the three conditions generally present when fraud occurs (i.e. incentive/pressure, opportunity and attitude/rationalisation). It can be difficult to determine risk factors that indicate an attitude permitting rationalisation of fraudulent activity. Nevertheless, we are alert to the existence of such risk factors in information we use to identify fraud risks as we perform other procedures.

To help identify fraud risks, we may ask others within the entity, including those outside of the financial function, the following questions:

- Have you observed anything unusual in your position?
- Has management ever asked you to do something that you consider unethical?
- Has management ever bypassed the "normal" process to record a journal entry, such as one without supporting documentation or one you thought is improper?
- Are you aware of recorded sales where risk has not passed to buyers?
- If someone of authority wanted to commit fraud, what would be the easiest way to do it?
- Have there been any significant unusual or complex transactions?
- What is management's attitude toward internal control?
- What controls are in place for sales cut off?
- What controls exist for recording journal entries?
- In most cases, these inquiries are a natural extension of the discussions we have during the audit.
- What policies and procedures ensure revenue is properly recorded?

Management Override

Due to the unpredictable way in which management override could occur, we consider the risk of management override of controls to be a fraud risk, and thus a significant risk. We document the specific risks relating to management override of controls (e.g., manipulation by management of current assets and liabilities to meet certain loan covenant requirements) as significant risks and our response to them.

Examples of management override of controls include:

- Recording fictitious journal entries, particularly close to the end of an accounting period, to manipulate operating results or achieve other objectives

- Inappropriately adjusting assumptions and changing judgments used to estimate account balances
- Omitting, advancing or delaying recognition in the financial statements of events and transactions that have occurred during the reporting period
- Concealing, or not disclosing, facts that could affect the amounts recorded in the financial statements
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity
- Altering records and terms related to a significant and unusual transaction

Common challenges implementing the risk based audit approach

The first set of challenges is documenting the auditor's understanding of internal controls, evaluating the design of controls, and determining whether such controls have been implemented. This is especially true when auditing small, less complex entity with limited internal controls that lack segregation of duties and formal policies. One need to be careful that the auditor is not a part of the client's internal control system.

Few believe it's an inefficient and futile exercise of preparing checklists without any benefit. While they do appreciate the theory of the standards, they feel that sometimes it adds many inefficient hours to the audit to complete pages upon pages of checklists, while not getting to the heart of the issue, which is the identification of significant risks and the tailoring of the audit plan to respond to those risks. The simple and most common reason is unavailability of time to make the change and fear to deviate from acquired methodology. However if auditor does the risk assessment in true spirit, it actually helps in identifying areas where they need to focus, thereby achieve efficiency and at the same time ensuring that all the procedures required to ensure that there is no risk of material misstatement are identified.

Revision of risk assessment

Having obtained and documented an understanding of the entity including its internal control, the auditor is now in a position to identify and assess the risks of material misstatement, which should be done at the financial statement level, and at the assertion level for classes of transactions, account balances and disclosures. The point of the risk assessment is to provide a basis for designing and performing further audit procedures.

Further, the auditor's assessment of the risks of material misstatement at the assertion level may change during the course of the audit as additional audit evidence is obtained. In circumstances where the auditor obtains audit evidence from performing further audit procedures, or if new information is obtained, either of which is inconsistent with the audit evidence on which the auditor originally based the assessment.

It may therefore be necessary to revise the original risk assessment, and modify the planned audit procedures in response to new or amended risks identified, accordingly auditor needs to remember that risk assessment is a continuous exercise.

Conclusion

One should remember and understand the importance of SA 315, as its requirements relating to risk assessment, which help to ensure that audits are responsive to audit client's circumstances, and when applied properly should help to reduce audit risk. Though the requirements of the SA can seem onerous, careful application of the standard and appropriate use of auditor's judgment should mean that compliance with documentation requirements is relatively straightforward.

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CA Paresh H. Clerk

Specific Responsibilities of Auditors

Introduction

As you know, the Standards on Auditing (SA) not only cover audit of financial statements so as to issue an audit opinion for the fair presentation of financial statements, but there are SAs which specify the responsibilities of the auditor when it comes to fraud or laws and regulations in an audit of financial statements and other similar responsibilities. Through this article, an attempt has been made to provide as much understanding as possible as to the auditor's responsibilities for specific circumstances as also audit processes/procedures, reporting and documentation in connection therewith in respect of the following SAs:

- SA 240 – Auditor's Responsibility Relating to Fraud in an Audit of Financial Statements
- SA 250 - Consideration of Laws and Regulations in an Audit of Financial Statements
- SA 450 - Evaluation of Misstatements Identified during the Audit

A. SA 240 – AUDITOR'S RESPONSIBILITY RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS ('FS')

Today, the enormity of fraud and the stakes involved are beyond imagination, with fraudsters using information technology to their benefit. Economies around the world have been impacted by fraud. Yet, there is no fool-proof manner of identifying, preventing or eradicating fraud.

The primary responsibility for the prevention and detection of fraud rests with the management and those charged with governance. Accordingly, most entities have their internal controls in place to prevent and detect frauds.

An auditor, in case of most entities, is responsible for obtaining reasonable assurance that FS taken as a whole are free from material misstatement, whether caused by fraud or error. In some case cases, the auditor is mandated by some laws and regulations to comment on the existence of fraud in an organisation. For example, Companies (Auditor's Report) Order,

2003, Para 4 Clause (xxi) requires the auditor to specifically report "whether any fraud on or by the entity has been noticed or reported during the year; if yes, nature and amount involved is to be indicated". Similar mandates also exist in the case of audit of banks. In this connection, SA 240 deals with the auditor's responsibilities relating to fraud in an audit of FS.

1. A delve into the concept of fraud

1.1 SA 240 defines 'fraud' as:

- an intentional act
- by one or more individuals among management, those charged with governance, employees, or third parties
- involving the use of deception to obtain an unjust or illegal advantage.

Although fraud is a broad legal concept, it is the fraud that leads to a misstatement in FS.

1.2 Intentional misstatements are of two types –

- resulting from fraudulent financial reporting, or
- resulting from misappropriation of assets

An intention to defraud may be due to pressures to meet earnings targets or expectations (and may be unrealistic) or a desire to maximise compensation based on performance or management intentionally takes positions that lead to fraudulent financial reporting by materially misstating the FS. In some entities, management may be motivated to reduce earnings by a material amount to minimise tax or to inflate earnings to secure bank financing.

There could be an incentive to misappropriate assets due to mere human greed or when one is living beyond one's means, he may have the incentive to misappropriate assets.

1.3 Fraudulent financial reporting may be accomplished by :

- Manipulation, falsification or alteration of accounting records or documents
- Intentional misapplication of accounting principles for amounts, classification, the manner of presentation, or disclosure

Fraud can be committed by management override of controls using techniques such as –

- Recording fictitious journal entries, particularly close to the end of the year
- Omitting, advancing or delaying recognition in FS of events and transactions that have occurred during the reporting period
- Engaging in complex transactions that are structured to misrepresent the financial position or financial performance of the entity

1.4 Misappropriation of assets can be accomplished in a variety of ways :

- Embezzling receipts – e.g. misappropriating collections on accounts receivable or diverting receipts in respect of written-off accounts to personal bank accounts
- Stealing physical assets or intellectual property
- Using an entity's assets for personal use

2. Objectives of the auditor

2.1 To identify and assess the risks of material misstatement in FS due to fraud;

2.2 To obtain sufficient appropriate audit evidence about the assessed risks of material misstatement due to fraud, through designing and implementing appropriate responses; and

2.3 To respond appropriately to identified or suspected fraud.

3. Auditor's responsibility

Fraud, being an intentional act to deceive would involve sophisticated and carefully organised schemes or ideas to conceal it and hence, the risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error and it would be more so difficult when it is by collusion. Further, the risk of the auditor not detecting a material misstatement resulting from management fraud is greater than for employee fraud.

Despite the inherent risks, an auditor is responsible for obtaining reasonable assurance that FS taken as a whole are free from material misstatement, whether caused by fraud or error. The auditor is required to maintain professional scepticism throughout the audit, recognising the possibility that a material misstatement due to fraud could exist, notwithstanding the auditor's past experience of the honesty and integrity of the entity's management and those charged with governance and at the same time keeping in view the potential for management override and the fact that audit procedures that are effective for detecting error may not be effective in detecting fraud.

The auditor may suspect or, in rare cases, identify the occurrence of fraud, the auditor does not make legal determinations of whether fraud has actually occurred.

4. Audit procedures

4.1 An active discussion with the engagement team about the susceptibility of the entity's FS to fraudulent misstatements is very useful in conducting an audit. Discussion may include matters like

- Factors affecting the entity that may create an incentive or pressure on management to commit fraud
- Risk of the management override of controls
- Unusual or unexpected changes in behaviour or lifestyle of management or employees
- Inconsistent responses by different levels of management
- Type of circumstances which may indicate the possibility of fraud

4.2 The auditor shall make inquiries with the management and others within the entity, to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity. The nature, extent and frequency of management's assessment of the risk of fraud and controls are relevant. Communications with the internal auditor, audit committee or the supervisory board (those charged with governance) about the susceptibility of the risk of fraud or even of actual fraud of past, will also be useful.

Discussions with the management and other key persons (say, operating personnel not involved in the financial reporting process, in-house legal counsel) in the entity may provide valuable insights. For example, the fact that management has not made an assessment of the risk of fraud may be indicative of the lack of importance that management places on internal control. Similarly, management of an SME may focus on the risks of employee fraud or misappropriation of assets.

4.3 Evaluation of fraud risk factors

SA 240 defines "fraud risk factors" as events or conditions that indicate an incentive or pressure to commit fraud

or provide an opportunity to commit fraud. The determination of the existence of a fraud risk factor and its impact on FS requires the exercise of professional judgment.

The chart below gives some examples of fraud risk factors for each of type of misstatements, the result of fraudulent financial reporting or misappropriation of assets:

A. Risk Factors Relating to Misstatements Arising from Fraudulent Financial Reporting

Related to incentive / pressure to commit fraud	Related to a perceived opportunity to commit fraud	Related to an ability to rationalise fraudulent action
• Financial stability threatened by high degree of competition • Operating losses making the threat of bankruptcy, hostile takeover imminent • Excessive pressure on management to meet market or third party expectations to procure financing or meet the aggressive profitability expectations of investor • Personal finacial situation of management threatened by entity's profitability	• The industry or the entity's operations provide opportunities to commit fraud – – Significant related-party transactions not in the ordinary course of business – Significant, unusual, or highly complex transactions, especially those close to period end – High attrition among sernior management – Deficient / ineffective or poorly implements internal control systems	• Known history of violations of L&R • Management interested in maintaining or increasing the entity's stock price • Dispute between shareholders in a closely held entity • Strained relationship between management and the current or predecessor auditor • Management failing to remedy known significant deficiencies in internal control on a timely basis.

B. Risk Factors Relating to Misstatements Arising from Misappropriation of Assets

Related to incentive / pressure to commit fraud	Related to a perceived opportunity to commit fraud	Related to an ability to rationalise fraud
• Pressure to meet personal financial obligations • Adverse relationships between the entity and employees created by known or anticipated future employee layoffs, changes to employee compensation or benefit plans, promotions, compensation, or other rewards inconsistent with expectations.	• Deficient / ineffective or poorly implemented internal control systems for assets • Inadequate management understanding of information technology, which enables information technology employees to perpetrate a misappropriation • Inadequate access controls over automated records, including controls over and review of computer systems event logs	• Disregard for the need for monitoring fraudulent action or reducing risks related to misappropriations of assets • Changes in behaviour or lifestyle that may indicate assets have been misappropriated • Tolerance of petty thefts

4.4 Evaluation of risk of fraud in revenue recognition

Revenue recognition often results from an overstatement of revenues (by premature revenue recognition or recording fictitious revenues) or understatement of revenues (through improperly shifting revenues to a later period). The risks of fraud in revenue recognition may be greater in some entities than others. For example, there may be pressures or incentives on management to commit fraudulent financial reporting through inappropriate revenue recognition in the case of listed entities when performance is measured in terms of year-over-year revenue growth or profit or where the entity intends to go for an IPO or PE funding.

The presumption that there are risks of fraud in revenue recognition may be rebutted. The auditor may conclude that there is no risk of material misstatement due to fraud relating to revenue recognition in the case where there is a single type of simple revenue transaction, for example, leasehold revenue from a single unit rental property. In such a scenario, the auditor should document his conclusion of the presumption that there is a risk of material misstatement due to fraud related to revenue recognition is not applicable.

4.5 Responses to the Assessed Risks of Material Misstatement Due to Fraud

Once the auditor makes an assessment of the risks of material misstatement due to fraud at the financial statement level, he shall determine general considerations apart from the specific measures or responses needed. Following is an indicative list (as per Appendix 2 of SA 240) of responses which an auditor may undertake:

4.5.1 Overall responses

Assignment and supervision of personnel: The auditor may assign additional individuals with specialised skills - forensic / IT experts to the engagement.

Unpredictability in the selection of audit procedures: Visiting locations or performing certain tests on a surprise or unannounced basis, using different sampling methods, etc.

4.5.2 Audit Procedures Responsive to Assessed Risks of Material Misstatement due to Fraud at the Assertion Level - The auditor may consider:

- Altering the audit approach in the current year. For example, contacting major customers and suppliers orally in addition to sending written confirmation, sending confirmation requests to a specific party within an organisation, or seeking more or different information
- Performing physical observation or inspection of certain assets, e.g. inventory counts at or near the end of the reporting period
- Performing computer-assisted techniques, such as data mining to test for anomalies in a population.
- Testing the integrity of computer-produced records and transactions
- Using an expert to develop an independent estimate for comparison to management's estimate
- Reviewing personnel files for those that contain little or no evidence of activity, for example, lack of performance evaluations

- Confirming specific terms of contracts with third parties.
- Reviewing the authorisation and carrying value of senior management and related party loans.

4.5.3 Audit Procedures Responsive to Risks Related to Management Override of Controls

Management is in a unique position to perpetrate fraud because of management's ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. The auditor shall design and perform audit procedures to:

a. Test the appropriateness of journal entries and other adjustments in FS.

Example – Though automated processes and controls may reduce the risk of inadvertent error, they do not overcome the risk that individuals may override such automated processes, by changing the amounts being automatically passed to the general ledger or to the financial reporting system. Accordingly, the auditor is required to make inquiries relating to journal entries and consider the need to test journal entries and other adjustments throughout the period or at the end of a reporting period.

b. Review accounting estimates

Fraudulent financial reporting is often accomplished through intentional misstatement of accounting estimates. This may be achieved by, say, understating or overstating all provisions or reserves in the same fashion to achieve a designated earnings level in order to deceive stakeholders. The auditor is required to evaluate the judgments and decisions made by the management in making accounting estimates. If required, the auditor may also perform a retrospective review of such accounting estimates to determine whether there is an indication of a possible bias on the part of management.

c. Evaluate the business rationale for significant transactions.

Where significant transactions are outside the normal course of business for the entity, or that otherwise appear to be unusual, the auditor shall evaluate whether the business rationale (or the lack thereof) of the transactions suggests that they may have been entered in to engage in fraudulent financial reporting or to conceal misappropriation of assets. Management taking decisions contrary to economic conditions, the involvement of third parties that are not financially in a position to support the transaction are some examples where the business rationale is defied.

4.6 Evaluation of audit evidence

The analytical procedures[1] performed by an auditor enable him to determine whether FS as a whole is consistent with his understanding of the entity and its environment or indicate a previously unrecognised risk of material misstatement due to fraud (say, reporting of large income in last few weeks of the year-

1 SA 520 – Analytical Procedures

end or unusual transactions). Such an evaluation may provide further insight whether there is a need to perform additional or different audit procedures. For example, an otherwise insignificant fraud may be significant if it involves senior management. In such circumstances, the reliability of evidence previously obtained may be called into question, since there may be doubts about the completeness and reliability of representations made by the management.

When the auditor confirms that previously obtained audit evidence is insufficient or is unable to conclude whether, FS are materially misstated as a result of fraud, the auditor shall evaluate the implications for the audit for which guidance is in SA 450 (discussed in this article) and SA 700.

4.7 Auditor unable to continue the engagement

Though not necessary, exceptional circumstances that may bring into question the auditor's ability to continue performing the audit, for example –

- The auditee does not take appropriate action regarding fraud that is considered necessary;
- The auditor's consideration of the risks of material misstatement due to fraud and the results of audit tests indicate a significant risk of material and pervasive fraud; or
- The auditor has significant concern about the competence or integrity of management or those charged with governance.

In such cases, the auditor shall determine his professional and legal responsibilities governing discontinuation of an audit engagement. Professional responsibilities include communication with the management or those charged with governance about the discontinuation of audit and the reasons thereof. In some cases, the auditor may not be permitted by the applicable L&R or in public interest to discontinue the audit. Also, his legal responsibilities may mandate him to communicate the nature of fraud and its implications to the regulatory authorities.

4.8 Management representations

Although the management acknowledges their responsibility for the preparation of FS, it is important that the management and, where appropriate, those charged with governance, acknowledge their responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud. The auditor shall obtain a written representation confirming that they have disclosed to the auditor:

- The results of management's assessment of the risk that FS may be materially misstated as a result of fraud; and
- Their knowledge of actual, suspected or alleged fraud affecting the entity.

4.9 Communications to appropriate persons or authorities

Where the auditor suspects or is convinced about the existence of fraud, he shall communicate the matter in a timely manner with the appropriate level of management, ordinarily, one level above the persons who appear to be involved with the suspected fraud. The communication is must even if the matter might be considered inconsequential, say, a minor defalcation by a lower level employee. If the auditor has identified or suspects the involvement of management or employees with a significant role in internal control or the fraud which may result in a material misstatement in FS, the auditor shall communicate to those charged with governance[2].

2 SA 260 – Communication with those Charged with Governance

The auditor also has to determine whether identified or suspected fraud is required to be reported under any other statute to an authority and that may have to be reported despite the auditor's confidentiality requirements under the terms of audit. In terms of Section 143(12) of the Companies Act, 2013, the auditor is required to communicate at the appropriate level as mandated therein. In case of audit of banks, the auditor has a statutory duty to report the occurrence of fraud to the supervisory authorities, i.e., the Reserve Bank of India.

4.10 Documentation[3 and 4]

Documentation, in the case of entities, where the auditor suspects a fraud should be comprehensive and must be maintained without fail. This may include:

- The significant decisions are taken regarding the susceptibility of financial statements to material misstatements due to fraud
- The identified and assessed risks of material misstatement due to fraud
- The nature, timing and extent of audit procedures performed to assess the impact of fraud on FS
- The results of the audit procedures
- Management representations and communications about fraud made to management, those charged with governance, regulators and others

B. SA 250 – CONSIDERATION OF LAWS AND REGULATIONS IN AN AUDIT OF FINANCIAL STATEMENTS

Laws and regulations **(L&R)** form an integral part of conducting business. Most of the business entities are governed by general L&R, yet, there are some entities which are heavily regulated with industry-specific L&R – for example, banks, NBFCs, insurance and chemical companies to name a few. Non-compliance with laws may cause to fines, penalties and other consequences such as, prosecution or closure of business, that may have a material impact on FS.

It is the primary responsibility of the management, with the oversight of those charged with governance, to ensure that the entity complies with the applicable L&R and that FS and disclosures adhere to such L&R. Many organisations have their internal control systems in place – SMEs as well as MNCs. Larger organisations generally have an internal audit function, an audit committee and a compliance officer.

Despite the internal controls and audit committee in place, the chances of non compliance with L&R cannot be ruled out and hence, the auditor should adopt professional scepticism during the course of his audit.

Whether an act constitutes non-compliance with L&R is a matter for legal determination, which could be beyond the auditor's professional competence to determine. Nevertheless, the auditor's training, experience and understanding of the entity/industry would come handy to apprehend what may constitute non-compliance.

1. Objective of SA 250

SA 250 assists the auditor in ***identifying material misstatement of FS due to non-compliance of L&R.*** The auditor is not responsible for preventing non-compliance and cannot be expected to detect non-compliance with all L&R.

This SA ***does not apply to assurance engagements*** in which the auditor is specifically engaged to test and report separately on compliance with specific L&R.

3 SA 315 – Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment

4 SA 330 – The Auditor's Responses to Assessed Risks

2. Understanding the concept of "non-compliance"

- Acts of omission or commission
- By the entity
- Either intentional or unintentional
- Contrary to prevailing L&R
- Excludes personal misconduct (unrelated to business) by those charged with governance, management or employees

3. Auditor's responsibility

There is always an unavoidable risk that material misstatements in FS, due to non-compliance of L&R, may not be detected, reasons being:

- many L&R affecting the operating aspects of an entity may not impact FS at all
- identification of non-compliance with L&R due to fraud/connivance is challenging
- whether an act constitutes non-compliance or not is often a matter of legal debate

Despite the aforesaid inherent risk, the auditor is required to maintain professional scepticism throughout the audit.

Auditor's responsibility is distinguished under two categories of L&R:

Types of L&R	L&R directly impacting FS	L&R not directly impacting FS, but fundamental to business operations
Auditor's responsibility	• Obtain sufficient appropriate evidence about compliance with these L&R • For specific statutory requirements, the audit plan should include appropriate tests for compliance with certain provisions of L&R; audit report also should specify how the requirements are addressed	• Undertake specified procedures to help identify non-compliance which may have a material impact on FS due to penalties, etc.
Examples	• Accounting Standards directly impact revenue recognition, recognition of assets and depreciation • Certain Provisions of the Companies Act, 2013 which directly impact the preparation and disclosures in FS. • Tax and labour laws • For Non-banking Finance Companies(NBFCs), the mode of valuation of investments should be based on the type of investments; a separate auditor's report to be given in terms of NBFC (Auditor's Report) Directions	• L&R requiring compliance with an operating licence, say, in the case of telecommunication companies, DOT circle licences • Environmental regulations as per laws applicable to pharmaceutical and chemical companies

4. Audit procedures

4.1 General audit procedures for determining non-compliance with L&R and assessing its impact on FS may include:

- Understanding the business of the entity and the applicable L&R
- How the entity is complying with these L&R
- Suitable inquiries with the management or those charged with governance about the internal controls / systems in place to ensure compliance with L&R and obtaining written representations where necessary
- Inspecting correspondence with the licencing / regulatory authorities

The above may be attained by use of appropriate comprehensive audit checklists, review of compliance report submitted to

the management or TCWG or concerned authorities, even studying audit or inspection report of the related regulator.

4.2 Audit procedures, when non-compliance is identified or suspected, may include:

- Understanding the nature of non-compliance and the circumstances in which it has occurred, say, non-payment of tax deducted at source (TDS)
- Obtain information to evaluate the possible impact on FS, provision relating to interest on non-payment or delay in payment of TDS
- Discuss the matter with the higher authorities - management or TCWG and request them to provide written representations for any known or suspected non-compliance
- Procure legal opinion, where necessary, for example, where the auditor does not receive sufficient information from the management he may consider procuring a legal advice to ascertain the impact of non-compliance on FS, including the possibility of fraud

4.3 Reporting of Identified or Suspected Non-compliance and documentation

- The auditor should communicate with TCWG (unless they are in management) matters involving non-compliance with L&R, unless those are clearly inconsequential. If the auditors suspect that management or TCWG are involved in non-compliance, the matter to be communicated to the next higher level, say, the audit committee or the Board of Directors
- Where the auditor identifies or suspects non-compliance, he may express an opinion on FS in accordance with SA 705 (Modifications to the Opinion in the Independent Auditor's Report):
  - o If the auditor concludes that the non-compliance has a material effect on FS, and has not been adequately reflected in FS, he shall express a qualified or adverse opinion on FS
  - o If the auditor is precluded by management or TCWG from obtaining sufficient appropriate audit evidence to evaluate whether non-compliance that may be material to FS has, or is likely to have, occurred, the auditor shall express a qualified opinion or disclaim an opinion on the FS
- Despite confidentiality agreement with the clients, an auditor may be obliged under certain laws to report non-compliance thereunder to the government authorities
- The auditor should also determine whether the auditor has a responsibility to report to the identified or suspected non-compliance to any other authority; say, in case of non-compliance of any provision of NBFC, the auditor is separately required to intimate to the Reserve Bank of India
- The auditor shall maintain adequate documentation for identified or suspected non-compliance with L&R – copies of records and documents, the minutes or results of the discussion with management or any other person

C. SA 450 – EVALUATION OF MISSTATEMENTS IDENTIFIED DURING THE AUDIT

The incidence of misstatements does arise during the course of the audit, it may be due to

amounts, classification, presentation or disclosure. Misstatements may result from an inaccuracy in gathering or processing data, the omission of an amount or disclosure, application of incorrect accounting estimate / policies and so on. Misstatements in FS may also arise on account of fraud / connivance of employees or management or those charged with governance.

The objective of the auditor

To evaluate :

- The effect of identified misstatements on the audit, and
- The effect of uncorrected misstatements, if any, on FS

1. Meaning of misstatement

A misstatement is the difference in the amounts, classification, presentation or disclosure of any item actually reported in FS, vis-a-vis those that are required to be reported as per the applicable reporting framework, that is, as per the generally accepted accounting principles, applicable accounting standards, and the related L&R. Misstatements may arise due to fraud or error, are distinguished as:

- Factual misstatements about which there is no doubt, say, inaccuracy in gathering or processing data or an omission of amount or disclosure
- Judgmental misstatements - differences arising from the judgments of management and the auditor about the accounting estimates, or the selection or application of accounting policies
- Projected misstatements being the auditor's best estimate of misstatements in populations, involving the projection of misstatements identified in audit samples to the entire populations from which the samples were drawn.

2. Audit procedures

2.1 The auditor shall accumulate misstatements identified during the audit, other than those that are "Clearly Trivial". "Clearly trivial matters" are inconsequential and the auditor may designate an amount below which misstatements would be clearly trivial and need not be accumulated, since accumulation thereof too would not have a material effect on the financial statements. 'Clearly trivial' does not mean it is 'not material'. For example, for a company with a turnover of ₹ 500 crores, ignoring to write off or make provision for all old Trade Receivables below ₹ 100 would be clearly trivial but not that of ₹ 10,00,000.

2.2 Each misstatement should be considered individually as well as in aggregate for determining the impact on FS. For example, if revenue has been materially overstated, the FS as a whole will be materially misstated, even if the effect of the misstatement on earnings is completely offset by an equivalent overstatement of expenses.

2.3 Based on misstatements identified, the auditor shall determine whether the overall audit strategy and audit plan need to be revised. Circumstances may suggest that other misstatements exist in addition to those identified. For example, where misstatements arose from a breakdown in the internal controls or inappropriate assumptions / valuation methods adopted across the entity, there are chances that other misstatements might also exist. Even a misstatement in recording purchase of items such as stationery due to collusion of the persons involved in custody, recording and authorising a transaction may suggest that other misstatements exist. Further, where the aggregate of misstatements accumulated during audit approaches materiality, there is a greater risk of the existence of undetected misstatements. In such cases, the auditor may modify its audit programme, size and type of sample, including the materiality level for classes of transactions, account balances or disclosures.

2.4 The auditor may request management to examine a class of transactions, account balance or disclosure and correct the misstatements that were detected and if corrected, the auditor is to perform additional audit procedures to determine whether the misstatements remain.

2.5 To obtain representations (with reasons) from management and, where appropriate, those charged with governance about uncorrected misstatements, as they may believe that the effect of uncorrected misstatements is not material or that those are not misstatements.

3. Communication, Reporting and Documentation

3.1 The auditor is required to communicate, on a timely basis, all misstatements with the appropriate level of management, unless prohibited by L&R and request the management to correct the same. Thus, communication enables management to evaluate and if it agrees, to take the necessary action, so as to correct misstatements.

3.2 If management refuses to correct some or all misstatements, the auditor shall record reasons for the same and evaluate whether FS as a whole is free from material misstatement.

3.3 There may be certain misstatements that are uncorrected by the management or those charged with governance. The auditor shall determine whether they are material[5], individually or in aggregate. If material, the auditor shall evaluate the effect of uncorrected misstatements on FS and report accordingly.

3.4 The audit documentation shall include:

- Criteria for determining misstatements that would be regarded as clearly trivial
- Misstatements accumulated during the audit and whether they have been corrected
- For uncorrected misstatements –
- Consideration of its aggregate effect
- Evaluation whether materiality level for particular classes of transactions, etc., individually or in aggregate, have exceeded and the basis for that conclusion
- Evaluation of the effect on key ratios or trends and compliance with legal regulatory and contractual requirements

Conclusion

As it may have been observed that other SAs also have an important role to play for conducting an audit of financial statements of any entity, be it large, medium or small. In the wake of increasing incidents of frauds, introduction of new laws/regulations and of course monitoring of its compliance, the auditor's responsibilities too have increased and have to be carried out in the utmost diligent manner so as to enhance the quality of audit and processes, which shall be attained by ensuring adherence to SAs discussed herein. These SAs, in addition to audit processes *per se*, emphasise on communication, reporting and documentation so as to enhance quality of an audit. Thus in nutshell, auditors, need to strictly comply with all SAs, undoubtedly strengthen their wherewithal so as to meet present/impending challenges, change perceptions of auditors as also to reach to the expectations of regulators.

Acknowledgement – I thank Ms. Urvi Asher, Chartered Accountant, for assisting me in the preparation of this article.

ABBREVIATIONS USED

a. L&R – Laws and Regulations
b. FS – Financial statements
c. IPO – Initial Public Offering
d. PE – Private Equity

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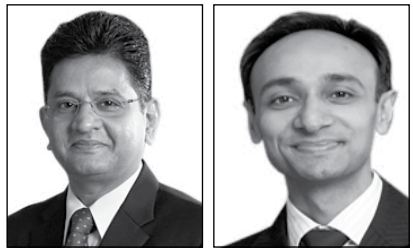
5 Para 12 of SA 320 - Materiality in Planning and Performing an Audit



CA Sandeep Shah & CA Bhavin Kapadia

Standards on Gathering of Audit Evidence

Backdrop

Obsessive documentation on social media (of one's life) may be the subject matter of deliberation but when it comes to compliance with Standards on Auditing and that too Audit Evidence, it is not a subject matter of dispute. If you cannot show it, you have not done it!

Stakeholders rely on auditor's opinion on the financial statement and they believe & have faith that auditors have followed the audit procedures and obtained audit evidence relevant for an audit opinion. Time and again, whenever material fraud surfaces in the public domain, the debate on accountability of auditors for not detecting the fraud and not following the audit procedures surfaces. An auditor's business is not an investigation, but assessing fraud in financial statements i.e. to check for misstatements and / or misappropriation of assets. However, the mood of the regulators and the common public seems to be otherwise. With this, the question that arises is, whether audit procedures applied are appropriate and sufficient audit evidence is gathered before issuing the auditor's report.

Statutory auditors in recent times have turned even more cautious and are not signing balance sheets of companies until they obtain sufficient appropriate audit evidence to support their opinion. Of late it was observed that many auditors have resigned as statutory auditors of listed companies. Failure to provide sufficient information by the management and gathering of sufficient audit evidence was the primary reason for such abrupt resignation

Standard on auditing which covers the aspects of audit evidence

Standards of Auditing (SA) issued by the Institute of Chartered Accountants of India (ICAI) are tools for the auditors which facilitate and guide in audit procedures to be followed and audit evidence to be gathered while conducting the audit responsibility. National Financial Reporting Authority has been given the powers to formulate the Standards of Auditing under section 143(10) of the Companies Act, 2013 and till such time they are stipulated, the SA issued by ICAI are binding. SA 500 to SA 599 as listed below focus on audit evidence.

SA	Particulars
500	Audit Evidence
501	Audit Evidence - Specific Considerations for Selected Items
505	External Confirmations
510	Initial Audit Engagements – Opening balances
520	Analytical procedures
530	Audit sampling
540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures
550	Related parties
560	Subsequent events
570	Going concern
580	Written representations

The relevance of gathering sufficient and appropriate audit evidence

Quality Review Board (QRB) established by the Government of India under the Chartered Accountants Act, 1949 conducts a quality audit of Auditing firms. *In the case of audit evidence, the focus of QRB is mainly to ascertain whether the engagement team has designed and performed audit procedures to obtain sufficient appropriate audit evidence to draw reasonable conclusions which forms the basis of an auditor's opinion.* QRB has released four reports covering the period 2012 to 2018 and these reports are good reference material for the auditing fraternity. Some of the key observations on audit evidence are summarised below:

1. Failure to maintain specific documentation to validate/test certain assumptions made by the actuary like discount rate, average life, attrition, average salary, future salary growth with base data sent to the actuary for determining the gratuity liability.
2. The process followed for selecting items for the purpose of designing a test of controls and test of details not documented. Significant risks identified by the audit team but complete audit procedure only by inquiry without obtaining sufficient audit evidence.
3. In case of external confirmations following matters were observed
   a. No control over external confirmations
   b. Failure to apply alternative audit procedures in cases where confirmation are not received
   c. No inquiry made for management refusal to send direct external confirmations and consequential assessment of risk of material misstatement in such cases & alternative procedures followed
4. Failure to remain alert, when inspecting records or documents, for arrangements or other information that may indicate the existence of related party relationships or transactions that management has not previously identified or disclosed
5. Analytical procedures performed were not documented. Though standard checklist was used and endorsement of 'Yes/No/NA' was made, however the extent of work /test performed was not mentioned nor signed by the partner / concerned team member in charge
6. Basis of selection of samples not documented and ensuring that entire population was covered for sampling purpose
7. Insufficient audit procedure in identifying and testing of related parties and their transactions
8. Failure to perform risk assessment procedures for considering whether there

are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. Checklist had not been filled up for evaluating going concern

9. Failure to obtain appropriate audit evidence for reporting requirement under Section 143(3)(g) of Companies Act, 2013 regarding disqualification of director

10. Failure to attend physical inventory counting and not performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count

Globally the audit quality is examined closely and International Forum of Independent Audit Regulators (IFIAR) has also highlighted their observations based on the inspection of global audit firm networks. This report also reiterates the relevance of audit evidence. *Their significant findings are mainly in the areas of engagement performance (i.e. failure to establish policies and procedures for engagement quality control review) followed by independence and ethical requirements (i.e. monitoring non-audit services and personal independence requirements).* The audit areas with most frequent findings which require reader's attention are given below:

1. Failure to assess the reasonableness of assumptions including consideration of contrary or inconsistent evidence

2. Failure to perform risk assessment procedure

3. Failure to obtain sufficient persuasive audit evidence to support reliance on manual controls. It also mentions about the failure to sufficiently test controls over, or the accuracy and completeness of, data or reports produced by management was observed in a number of cases and, to a lesser extent, the failure to test sufficiently information technology general and application controls.

4. Failure to appropriately assess and respond to the risk of fraud in revenue recognition; to perform procedures to determine whether revenue was recorded in the appropriate period; and to understand sufficiently the terms and conditions of complex arrangements and the impact on the accounting.

Wherever required, QRB refers the deficiencies to the Disciplinary Committee of the ICAI to take corrective action against the audit firms being reviewed.

The journey from traditional to modern techniques of gathering audit evidence

Digital India has been the theme of our Prime Minister. Traditional methods of auditing in regard to sampling, vouching, balance confirmations, documentation are slowly replaced by technology driven modes through audit tool software which enables end-to-end audit functions including audit planning, raising of audit queries to client and response from the client which will form part of the audit trail.

Artificial Intelligence (AI) tool is still evolving in India for the purpose of audits with 'Big Data'. Such tools may be used for audit sampling, cut-off procedures, ledger scrutiny with more accurate and unbiased observation, etc. It can point out specific items of financials which has the possibility of error or fraud. However, this will take a longer time to settle down and changing the mindset of audit fraternity.

Further, maintaining audit evidence in the form of electronic records would help in faster

retrieval and also save the valuable natural resources.

Recently ICAI has also launched the portal for obtaining unique documentation identification number which will facilitate the users to ensure that the documents attested by the Chartered Accountants are authenticated. Currently this is implemented on the recommendatory basis and certainly in long run it would become mandatory.

Key concepts

Auditor's opinion is certainly based on a test check of the transactions, controls and other audit procedures followed by them based on their best judgments. We believe that the reliability of the information provided by the management to the auditor is utmost relevant for the auditor's judgment to decide the extent of audit evidence to be obtained. At the helm of all the audit procedures followed by the audit firms, *it is driven by the firm's quality control procedures for client acceptance and continuance i.e. Standard on Quality Controls (SQC) 1*. The audit firm should establish policies and procedures requiring appropriate documentation to provide evidence of the operation of each element of its system of quality control.

An independent auditor has to be reasonably satisfied as to whether the information contained in the underlying accounting records and other source data is reliable for the preparation of financial statements. To obtain reasonable assurance about the financial statements the auditor needs to design and perform audit procedures to obtain sufficient appropriate audit evidence to be able to draw reasonable conclusions on which to base the auditor's opinion.

As defined in SA 500, audit evidence is the information used by the auditor in arriving at the conclusions on which the auditor's opinion is based. Audit evidence includes both, information contained in the accounting records underlying the financial statements and other information.

The key concepts which revolve around the overall framework of audit evidence are:

1. Nature of evidence
2. Appropriateness
3. Sufficiency
4. Evaluation

Sufficient & appropriate audit evidence is the measure of the quality and quantity of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based. The quantity of audit evidence needed is affected by the auditor's assessment of the risks of misstatement (the higher the assessed risks, the more audit evidence is likely to be required) and also by the quality of such audit evidence (higher the quality, less may be required). Obtaining more audit evidence, however, may not compensate for its poor quality. The auditor should determine the necessary modifications / additions to audit procedures if the auditor has doubts over the reliability of the audit evidence.

Audit procedures involved to verify certain assertions in respect of specific classes of transactions, account balances and disclosures

- Inquiry
- Inspection
- Observation
- Risk assessment procedure (identify high-risk areas)
- Substantive & Analytical procedures
- External confirmation
- Test of controls
- Recalculation
- Reperformance

- Evaluate the work performed by an expert and its appropriateness to be considered as audit evidence
- Evaluate the reliability of information produced by the entity

Following are the factors through which reliability of the evidence is increased:-

- Internal evidence reliability increases when internal control is effective
- External evidence is more reliable than internal evidence due to the absence of the involvement of the client.
- The written form of evidence is more reliable
- If the audit evidence is obtained from original documents then they are more reliable rather than photocopies.

Management representation does not substitute for lack of audit evidence

Representations by management cannot be a substitute for other audit evidence that the auditor could reasonably expect to be available. For example, a representation by management as to the quantity, existence and costs of inventories is no substitute for adopting normal audit procedures regarding verification and valuation of inventories. In case an auditor is unable to obtain sufficient and/or appropriate audit evidence regarding any matter which has or may have a material effect on the financial information, this will constitute a limitation on the scope of his examination even if he has obtained a representation from management on the matter.

Audit procedure to be followed in certain areas of the audit to gather audit evidence

There are areas which require auditors to take additional care and adopt alternative audit procedures in certain cases. Few areas are covered below along with audit procedure:

1. **Stock with a third party (job-worker)**
   a. Auditor's representative has to visit the site for the year-end physical count (this is the most preferred approach). In case of remote places, auditors can ask the company to obtain a certificate from independent chartered accountant / consultant
   b. Insurance coverage (with specific inclusion of name an address of job-worker) could also be looked into by the auditors
   c. Verification of gate outward register and delivery challans. With the introduction of the e-Way Bill, it is now possible to track physical movement of goods
   d. To check the events subsequent to balance sheet i.e. goods received from job worker
   e. Obtain ageing report for a stock with job-worker and inquire the reason for the significant delay in receipt of material, any obsolete or damage material in stock
   f. Auditors should refer to the terms of job order and delivery timelines given therein
   g. Direct balance confirmation can be sought from the job-worker for stock-in-hand

2. **Revenue recognition including cut-off procedures, terms of customer contracts and Trade Receivable**
   a. Audit sampling considering the entire population of revenue and selecting samples from each of the segment and location

b. Inquiry for internal checks and balances. Additionally, we have to test check the effectiveness of internal financial controls on such areas [e.g. outstanding balances exceeding credit limits approved]

c. Trend analysis of sales of products / services [month-wise, product, customers, location]. Inquire for any changes as compared to the earlier period

d. Post-vouching is a relevant step to identify if there are any items pertaining to a year of audit recorded subsequent to year end [e.g. debit notes / credit notes, sales returns, year-end volume discounts etc.]

e. Delivery / lorry receipts (e-Way Bills under GST) in case of domestic sale of goods and bill of lading in case of exports [terms of sales (in particular when the control is passed for Ind AS 115) should be considered as per the principles laid in Ind AS 115 and AS 9]

f. In case of service revenue, cut-off procedures should include mapping the milestone billings with the terms of mandate and progressive billing in the case where revenue is recorded as per percentage completion method

g. Obtain direct balance confirmation from selected parties [high value, region-wise]

h. Check whether the outstanding balances of the parties are within the credit limits

i. Inquire and check subsequent realisation up to the date of the audit

j. Validate the provision made against doubtful recovery and reconciling the ageing report with the debtor's sub-ledger / control accounts. If there is a change in provisioning norms or carve out then alternate steps should be considered and documented.

3. Completeness and litigation claims involving the entity

3.1 Audit procedures to be designed and performed by the auditor to identify litigations and claims include:

a. Inquiry with management and, where applicable, others within the entity, including in-house legal counsel

b. Reviewing minutes of meetings of those charged with governance and correspondence between the entity and its external legal counsel

c. Reviewing legal expense accounts which include verifying invoices for legal expenses

d. Using information obtained through risk assessment procedures carried out as part of obtaining an understanding of the entity and its environment to assist the auditor to become aware of litigation and claims involving the entity.

3.2 In case auditor identifies the existence of such litigations and claims:

a. They may seek direct communication with the entity's legal counsel through a letter of general inquiry prepared by management and sent by the auditor requesting direct communication by legal counsel with him

b. If law, regulation or the respective legal professional body prohibits the entity's external legal counsel from communicating directly with the auditor, the auditor shall perform alternative audit procedures. These include seeking direct communication through a letter of specific inquiry containing the following matters:

i. list of litigations and claims

ii. management assessment of outcome along with financial implications

iii. confirmation from external legal counsel about the reasonableness of the above assessment and provide further information if the list is incomplete or incorrect

3.3 The auditor shall modify his opinion in accordance with SA 705 where:

a. Management refuses permission to the auditor to communicate or meet with entity's external legal counsel or entity's external legal counsel refuses to respond to the letter of inquiry or is prohibited from responding; and

b. The auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures.

3.4 Auditor shall request management / those charged with governance to provide written representations that all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements have been disclosed to the auditor and appropriately accounted for and disclosed in accordance with the applicable financial reporting framework.

4. Presentation and disclosure of segment information

Broadly the principles laid down under IGAAP AS 17 'Segment Reporting' and Ind AS 108 'Operating Segment' are same. The auditor has to inquire with management about how the resources are allocated to segments and assess the performance of the operating segment. The overall organogram of the company could also be looked into to assess the segments, functions and service lines. The auditor has to obtain the details of revenue / customers / location to ascertain the quantitative thresholds limits given in the accounting standard i.e. 10%. The auditor has to also inquire how the financial results / performance are shared internally with Chief Operating Decision maker (the CEO/ COO/ group of executive directors, Board of Directors).

Practical consideration governing

SA-505 – External Confirmations

External confirmation is defined as audit evidence obtained via direct written response to the auditor from a third party (the confirming party), in paper form, or by the electronic or another medium. The significant processes are defined in above standard e.g. *about maintaining control (para 7), selecting the appropriate confirming party (para A2), validating addresses (para A6), electronic responses (para A12), involvement of third parties (para A13) and Para 12 for alternative approach to be followed by the auditor when there is no response received.* Many digital based service providers have started offering such services and in case their services are used, it must be ensured that all the requirements of SA are followed. It is imperative that the data must be secured and tamper proof. Generally, the management does not wish to send the confirmations to the vendors and in that event, it is essential to enquire reasons for the same and perform further alternative procedures (paras A18

& A19 of SA 505) to eliminate the risk of misstatements. It should also be noted that only because there are balances due from/to related parties, the confirmation procedure should not be eliminated and they should be obtained.

Considering the shorter duration in closing the annual accounts, many times, the confirmations are sought at a period other than year end. In such cases, the audit procedures to ensure that cut-off procedures, the risk of material misstatement at year end etc. have to be factored in.

SA-520 – Analytical Procedures

Analytical procedures are of extreme importance to an auditor as they can help an audit be both, more efficient and effective when compared to the test of details such as sampling. There are various methods that may be used to perform analytical procedures including performing simple year over year comparisons of balances, transaction streams or ratios to performing complex analyses using advanced statistical techniques. The level of audit evidence obtained from analytical procedures is directly tied to their sophistication & more complete the analysis is, more persuasive the audit evidence. The challenges in small to medium size entities are that they do not generate periodical (monthly/ quarterly) financial information and hence only limited analytical procedures can be carried out. This aspect should be borne in mind and additional procedures will be required.

There are three general categories of analytical procedures, those used as a risk assessment procedure, substantive analytical procedures, and those that assist when forming an overall conclusion. Analytical procedures performed as risk assessment procedures may include both financial and non-financial information. For a restaurant industry, it can be a relationship between sales and number of seats or average billing per person, turn-around time, cash to credit (digital-based payments), food consumption ratio, electricity consumption, number of waiters & other staff etc.

The substantive procedures used by an auditor may include tests of details, substantive analytical procedures, or a combination of both. Ultimately, the determination of which procedure to perform is based on the expected effectiveness and efficiency of the available audit procedures to reduce audit risk at the assertion level to an acceptably low level. Often, when applied appropriately they will provide better audit evidence than do tests of detail and in many instances are also more efficient than tests of detail. The last category of analytical procedures is used near the end of the audit that assists the auditor when forming an overall conclusion as to whether the financial statements are consistent with the auditor's understanding of the entity. This is based on an audit of individual components or elements of the financial statements. Some of the examples would be likely level of inventory, trade receivables/ payables, fixed assets etc. based on audit of individual component- if the financial statements reflect balances which are not in sync with the understanding, revised procedures will have to be applied.

SA-530 – Audit Sampling

The sample size selected should be adequate to mitigate the risks of material misstatement, should be adequately documented, and in those of sample selection which was on the basis of professional judgment taking into account selecting specific items and audit sampling, the system of selection should be documented comprehensively. Sometimes the common error is made in conducting the test of controls/test of details of entries which are recorded at the beginning of each of the months without covering the other dates as well.

SA-540 – Accounting Estimates

The financial statements can be prone to material misstatement due to errors in accounting estimate. Significant emphasis should be given while auditing the estimates. Whether the entity will be able to earn taxable income or not and consequently whether the deferred tax asset arising out of accumulated tax losses should be recognised or not is a subject matter of estimation and hence a very strong audit procedure needs to be followed. Fair Value Measurement is another area which requires sufficient skills as by nature, they are more subjective. Further, there is a number of variables and potential assumptions involved, each with a range of reasonableness, which increases the difficulty of auditing them as compared to other accounting estimates.

SA-550 – Related Parties & SA – 570 Going Concern

Apart from the legal requirements stipulated by the Companies Act and regulators like SEBI surrounding related parties' transactions, compliance with SA 550 is daunting as in some circumstances transactions with related parties give rise to higher risks of material misstatement of the financial statements than transactions with unrelated parties. If the business of the entity is entirely dependent on the support of related party example in case of back office exclusively set up for the parent or group company, going concern assumption can be vitiated and hence sufficient auditing procedures should be followed. Effective financial year commencing on or after 1st April 2017, it will require the auditor to apply the requirement of revised SA 570 wherein there is separate reporting about material uncertainty related to going concern.

SA-560 – Subsequent Events

Considering that directors are insisting on sufficient time to study the audited financial statements before the board meeting, it is imperative that compliance with this standard is carried till the date on which the accounts are adopted and signed by the auditors as any material event from the date of circulation till the date of adoption will have to be factored in and if necessary, effect given to.

Key Audit Matters

As per the newly introduced Standard on Auditing SA 701 Communicating Key Audit Matters in the Independent Auditor's Report, matters that pose challenges to the auditor in obtaining sufficient appropriate audit evidence or pose challenges to the auditor in forming an opinion on t15

dit matters which will form part of the auditor's report. The auditor's determination of key audit matters is based on the results of the audit or evidence obtained throughout the audit. This has to be communicated to management and those charged with governance. This SA 701 is effective from 1st April 2018 for an audit of listed entities.

Concluding

Auditors have to stick to their basics of auditing and follow the principles as laid down in SQC 1 to fulfil the responsibilities cast on the auditor. In order to achieve quality control improvement, auditors can apply the framework of Lean Six Sigma as the audit process is similar to the assessment process. "DMAIC" (define, measure, analyse, improve, control) can be applied to any business process or objective and the results are there for the auditors to see! In conclusion, auditors should endeavour to inculcate such principles and apply the professional scepticism to strengthen the audit evidence.

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CA Hasmukh B. Dedhia

Audit Conclusions and Reporting Standards

1. Setting the context

1.1 Audit/Assurance engagements were always onerous and are becoming more and more so in the wake of increased regulatory overview, additional responsibilities cast in the newer legislations and enhanced expectations of variety of stakeholders using the general purpose financial statements of the entities.

1.2 The role of auditors has become subject matter of widespread debate following several global financial crises and in India, more so recently, post instances of some auditors giving up their assignments in the midst of their tenure. Financial statement users including investors, analysts, members, lenders, revenue authorities, regulators and others have criticised the auditor's report for being too influenced by standard text with insufficient relevant information about the actual content of the audit or the items in the financial statements that are considered risky or of high importance. Standardisation of statutory audit report format is considered desirable but for a section of readers/users of financial statements, it also is perceived as too much of stereotype information without much meaningful communication.

1.3 The audit report is a culmination of the entire set of audit processes and verification exercise like gathering and examining evidences, evaluating the estimates and judgments of the preparers of financial statements, cut-off, confirmations and other procedures carried out in course of the audit. Undoubtedly, the auditor has insight to several areas of the auditee and its financial condition as well as internal governance practices. The reader of audit report expects more from the audit report. The gap between public expectations about the role of auditors and what is stated in audit report is something that concerns several stakeholders.

1.4 After the financial crisis in 2007, the users of financial statements called for an auditor report that is more informative and relevant. The International Auditing and Assurance Standards Board ('IAASB'), which issues International Standards on Auditing ('ISA'), acknowledging the need for enhanced auditor reporting being critical to influencing the value of the financial statements and for the continued relevance of the audit profession, issued a set of new and another set of revised audit reporting standards in January 2015, which are aimed at enhancing the communicative value and relevance of the

auditor's report. The IAASB further modified the design of the report to accommodate evolving national financial reporting regimes while ensuring that common and essential content is being communicated. These standards are effective for audits of financial statements for periods ending on or after 15th December 2016. Another set of amendments are also made to audit reporting standards recently by IAASB. One of the glaring changes brought in includes ISA 701 "Communicating the Key Audit Matters" ('KAMs') which requires the audit report to contain significant matters discussed with the auditee management in course of the audit. **This new requirement is expected to go a long way in making audit reports more dynamic and readable.**

1.5 The Standards on Auditing (SAs) in India, which now find their place and due recognition in the Companies Act, 2013, are largely consistent with the International Standards on Auditing (ISAs). The Institute of Chartered Accountants of India (ICAI) has made corresponding changes and issued the new and revised standards on the same lines as the IAASB. Most of the revised standards are applicable for audits of financial statements for periods beginning on or after 1st April 2018. The ICAI has also issued an Implementation Guide to SA 701 in February 2018 (Communicating the Key Audit Matters in the independent auditor's report). The Implementation Guide includes focused and detailed guidance on issues relating to KAMs as well as frequently asked questions. In May 2018, the ICAI also issued the revised edition of "Implementation Guide on Reporting Standards (Revised SA 700, Revised 705 and Revised 706)" to align the same to revised standards on the matters of audit reporting.

2. SA 700: "Forming an opinion and reporting on Financial Statements"

2.1 The Standards on Auditing (SA) 700 deals with the auditor's responsibility to form an opinion on the financial statements. It also deals with the form and content of the auditor's report issued as a result of an audit of financial statements.

2.2 This SA applies to an audit of a complete set of general purpose financial statements. The term 'complete set' is given in the standard. Thus, it excludes financial statements prepared during the interim period or prepared for any other purpose, (i.e., special purpose financial information or statements). SA 700 defines general purpose financial statements as those prepared in accordance with the general-purpose framework. The general-purpose framework within the financial reporting framework is further divided into fair presentation framework and compliance framework.

2.3 The "fair presentation framework" is *financial reporting framework that requires compliance with the requirements of the framework and (i) Acknowledges explicitly or implicitly that, to achieve fair presentation of the financial statements, it may be necessary for management to provide disclosures beyond those specifically required by the framework; or (ii) Acknowledges explicitly that it may be necessary for management to depart from a requirement of the framework to achieve fair presentation of the financial statements. Such departures are expected to be necessary only in extremely rare circumstances*. (Para 7(b) of SA 700). It is pertinent to note that the Standard has given an explicit right to management to depart from framework to achieve fair presentation. However, there is a caveat added wherein such departures are expected to be only in extremely rare circumstances along with additional disclosures. The Compliance framework requires compliance with the requirements of the framework but does not contain any acknowledgements stated in paras (i) and (ii) abov as covered by the fair presentation framework.

2.4 SA 700 (R) aims at addressing an appropriate balance between the need for consistency and comparability in auditor reporting globally and the need to increase the

value of audit reporting by making the information provided in the auditor's report more relevant to users. The standard also recognises the need for flexibility to accommodate particular circumstances of respective jurisdictions. Thus, one of the objectives of this standard is to express clearly the audit opinion through a written report. The Standard acknowledges the auditor to provide more clarity rather than a '**templatized**' approach earlier.

2.5 Comparative table of Format and Structural changes in Auditor's report as per SA 700 Revised

Para	Audit Report (old format) up to 31-3-2018	Audit report (new format) from Accounting periods beginning on/after 1-4-2018 with major changes
01	Title and addressee	Title and addressee
02	Introductory paragraph	Auditor's opinion • What has been audited • What is the opinion (it is considered fit to express the audit opinion upfront in the report as compared to the old format much later in para 06)
03	Management responsibility (With some additional matters, like going concern and overviewing of FS are added in revised format at para No 08)	Basis for Opinion • Modification • How was the audit undertaken (Reference to SA specified under 143(10) of the Act) • Statement on independence: The declaration of independence is new requirement to be put in audit report, draft whereof is as under: *"We are independent of the Company in accordance with the Code of Ethics issued by the Institute of Chartered Accountants of India together with the ethical requirements that are relevant to our audit of the financial statements under the provisions of the Companies Act, 2013 and the Rules thereunder, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the Code of Ethics."*
04	Auditor's responsibility (Enhanced description of auditor's responsibilities contained in Para 09 of the revised format)	Going concern paragraph (where events or conditions which may cast significant doubt on the entity's ability to continue as a going concern have been identified and/or a material uncertainty exists.)

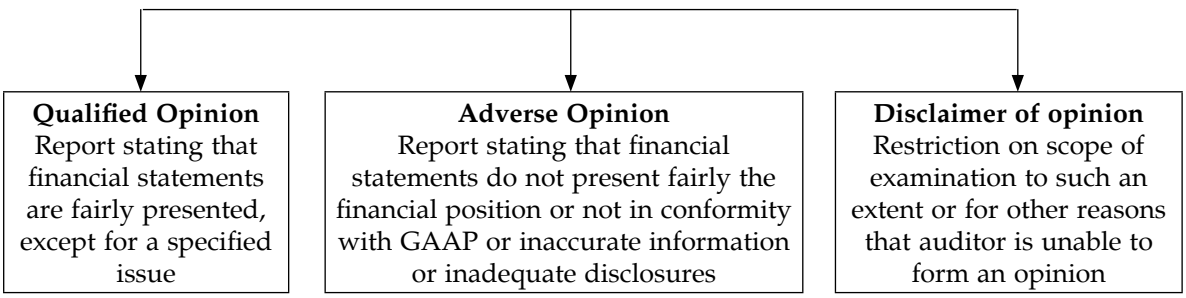
Para	Audit Report (old format) up to 31-3-2018	Audit report (new format) from Accounting periods beginning on/after 1-4-2018 with major changes
05	Basis for opinion (now in para 03 of the revised format)	Emphasis of Matter Paragraph (may be presented before or after KAM)
06	Auditor's opinion (now in para 02 of the revised format)	Key audit matters (applicable to listed companies only for the most significant matters in current year's audit)
07	EOM and/or Other Matters Para (now in paras 05 and 07 of the revised format)	Other Matters Para
08	Report on other legal and regulatory requirements	Management responsibilities • Preparation of Financial Statements • Going concern assessment *In preparing the financial statements, management is responsible for assessing the Company's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Company or to cease operations, or has no realistic alternative but to do so.* • Identifying who is responsible for oversight of financial reporting process *The Board of Directors are also responsible for overseeing the Company's financial reporting process.*
09	Signature, date of the report and membership number and place of signature	Auditors responsibilities for the audit of the financial statements • Objectives of the Audit • Statement for level of assurance Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with SAs will always detect a material misstatement when it exists Views or opinion on • Exercise of professional judgment • Misstatement

Para	Audit Report (old format) up to 31-3-2018	Audit report (new format) from Accounting periods beginning on/after 1-4-2018 with major changes
		• Internal controls • Accounting policies • Going concern assessment • Overall evaluation of financial statements • Communication with those charged with governance
10		Report on other legal and regulatory requirements
11		Signature, date of the report and membership number and place of signature

2.6 The revised format and structure of the audit report: Two glaring changes need to be noted from the above table. (1) The conclusion of the audit report or the opinion para is now placed in the beginning of the report and all other para (like management responsibility, auditor's responsibility, regulatory matters, etc.) have been pushed below in the format of the revised report (2) Inclusion of KAMs in audit reports of the listed companies

3. SA 705: "Modifications to the Opinion in the Independent Auditor's Report"

3.1 Types of Modified Opinion



Which type of modification to be used by the auditor and when is depicted in table below:

Nature of matter giving rise to the Modification	Auditor's Judgment about the pervasiveness of the effects or possible effects on the financial statements	
	Material but not pervasive	Material and pervasive
Financial statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain sufficient appropriate audit evidence	Qualified Opinion	Disclaimer of Opinion

- What is Material to be determined as per the guidance given in SA 320 & SA 450

- Pervasive: - Those effects on Financial Statements which in auditors' judgments:
  - (i) Are not confined to specific elements/ account/ item of financial statements,
  - (ii) If so confined are significant enough to affect the financial statements,
  - (iii) Not containing disclosures fundamental to the understanding by users.

Qualified Opinion

3.2 The auditor shall express a qualified opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are material, but not pervasive, to the financial statements; or the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, but the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive.

3.3 A misstatement is a difference between the amount, classification, presentation, or disclosure of a reported financial statement item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Accordingly, a material misstatement of the financial statements may arise in relation to:

(a) The appropriateness of the selected accounting policies;

(b) The application of the selected accounting policies; or

(c) The appropriateness or adequacy of disclosures in the financial statements

3.4 For appropriateness of selected accounting policies, a material misstatement may arise when the selected accounting policy is not consistent with the applicable financial reporting framework or the financial statements including the notes do not represent the underlying transactions and events in a manner that achieves fair presentation (Para A4 of SA 705).

3.5 In relation to the application of the selected accounting policies, material misstatements of the financial statements may arise when management has not applied the selected accounting policies consistently with the financial reporting framework, including when management has not applied the selected accounting policies consistently between periods or to similar transactions and events (consistency in application); or due to the method of application of the selected accounting policies (such as an unintentional error in application). (Para A6 of SA 705).

3.6 In relation to the appropriateness or adequacy of disclosures in the Financial Statements, material misstatements of the Financial statements may arise when the Financial Statements do not include all of the disclosures required by the applicable financial reporting framework; or the disclosures in the financial statements are not presented in accordance with the applicable financial reporting framework; or the financial statements do not provide the disclosures necessary to achieve fair presentation. (Para A7 of SA 705).

3.7 Illustrations of Basis of Qualified opinion (based on publicly available information):

(a) Basis for Qualified Opinion

As stated in Note 33(a) to the standalone Financial Statements the Company's non-current investments as at 31st March 2018 include investments aggregating ₹ 630.83 crore in two of its subsidiaries; and non-current loans other non-current financial assets and other current financial assets as at that date include dues from such subsidiaries aggregating ₹ 580.75 crore ₹ 43.42 crore and ₹ 6.63 crore respectively being considered good and recoverable by the management considering the factors stated in the aforesaid note including valuation report from an independent valuer. However, these subsidiaries have accumulated losses and their consolidated net worth is fully eroded. Further these subsidiaries are facing liquidity constraints due to which they may not be able to realize projections made as per their respective business

plans. In the absence of sufficient appropriate evidence, we are unable to comment upon the carrying value of these non-current investments and recoverability of the aforesaid dues and the consequential impact if any on the accompanying standalone Financial Statements. Our audit opinion on the standalone Financial Statements for the year ended 31st March 2017 was also qualified in respect of this matter.

(Audit report of Hindustan Construction Company Limited for FY 2017-18)

(b) Basis for qualified opinion

In common with many not-for-profit organisations, Aspen Family & Community Network Society derives revenue from donations, the completeness of which is not susceptible to satisfactory audit verification. Accordingly, verification of these revenues was limited to the amounts recorded in the records of Aspen Family & Community Network Society. Therefore, we were not able to determine whether as at and for the years ended March 31, 2018 and 2017, any adjustments might be necessary to donation revenue or excess of revenues over expenses reported in the statements of revenues and expenses, excess of revenues over expenses reported in the statements of changes in net assets and cash flows, and current assets and unrestricted net assets reported in the statements of financial position. This caused us to qualify our audit opinion on the Financial Statements as at and for the year ended March 31, 2017.

(Audit report of Aspen Family and Community Network Society)

(c) Basis for qualified opinion

The Company had, in an earlier financial year, reinstated an advance of ₹ 327.50 lakh which was previously written-off as not recoverable. Accordingly, the loss in Surplus (Profit & Loss) under Other Equity is lower and Other Non-Current Assets is higher by the said amount.

(Audit report of Prime Securities Limited for the year ended March 31, 2018)

(d) Basis for modified opinion

Attention is drawn to Note 13.3 regarding the payment of managerial remuneration in excess of amount payable as per the provisions of the Act to the Managing Director and Wholetime Director aggregating to ₹ 140.25 lakh in F.Y. 2015-16 for which application for approval of Central Government is being made.

(Audit report of Aptech Limited for the year ended March 31, 2016)

Disclaimer of Opinion

3.8 The auditor shall disclaim an opinion when the auditor is unable to obtain sufficient appropriate audit evidence on which to base the opinion, and the auditor concludes that the possible effects on the Financial Statements of undetected misstatements, if any, could be both material and pervasive.

3.9 The auditor shall disclaim an opinion when, in extremely rare circumstances involving multiple uncertainties, the auditor concludes that, notwithstanding having obtained sufficient appropriate audit evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the Financial Statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements.

3.10 If the auditor is unable to obtain sufficient appropriate audit evidence, the auditor shall determine the implications as follows:

(a) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, the auditor shall qualify the opinion; or

(b) If the auditor concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, the auditor shall:

(i) Withdraw from the audit, where practicable and possible under applicable law or regulation. Before withdrawing, the auditor shall communicate to those charged with governance any matters regarding misstatements identified during the audit that would have given rise to a modification of the opinion; or

(ii) If withdrawal from the audit before issuing the auditor's report is not practicable or possible, disclaim an opinion on the financial statements.

3.11 The auditor's inability to obtain sufficient appropriate audit evidence may arise from:

(a) Circumstances beyond the control of the entity:

- The entity's accounting records have been destroyed.
- The accounting records of a significant component have been seized indefinitely by governmental authorities.

(b) Circumstances relating to the nature or timing of the auditor's work:

- The entity is required to use the equity method of accounting for an associate entity, and the auditor is unable to obtain sufficient appropriate audit evidence about the latter's financial information to evaluate whether the equity method has been appropriately applied.
- The timing of the auditor's appointment is such that the auditor is unable to observe the counting of the physical inventories.

(c) Limitations imposed by management:

- Management prevents the auditor from observing the counting of the physical inventory.
- Management prevents the auditor from requesting external confirmation of specific account balances.

3.12 Illustration of Disclaimer of Opinion

Basis for Disclaimer of Opinion

1. *We could not observe the counting of physical inventories in the absence of information available and restriction placed by the Management. Accordingly, we were unable to satisfy ourselves by alternative means concerning the inventory quantities held at 31st March, 2013 and 31st March, 2014 which are stated in the Balance Sheet at ₹ 44,11,593 and ₹ 44,11,593 respectively.*

2. *In addition, we were unable to confirm or verify by alternative means balance of accounts receivable ₹ 2,957,822,918 and balance of accounts payable ₹ 244,505,890 and corresponding translation gain or loss, if any on these balances is not recorded for the year ended 31st March, 2014 and same matter was reported in previous year.*

3. *We are also unable to confirm the bank balance (including working capital facility and overdraft) and interest payable thereon since the accounts are frozen by the consortium of banks and by income tax authorities and as a result facility has been ceased to be operational and same matter was reported in previous year.*

4. *The Company has been unable to renegotiate its borrowings from its bankers and also incurred loss in current year and previous year. Without such financial support there is substantial doubt that it will be able to continue as a going concern. Consequently, adjustments may be required to the recorded asset amounts and classification of liabilities. The financial statements (and notes thereto) do not disclose this fact.*

As a result of these matters, we were unable to determine whether any adjustments might have been found necessary in respect of recorded or unrecorded inventories, bank balance (including overdraft facilities) and interest payable thereon and accounts receivable/payable and the

elements making up the Statement of Profit and Loss and the Cash Flow Statement.

[Audit report of Classic Diamonds (India) Limited for year ended March 31, 2014]

Adverse Opinion

3.13 The auditor shall express an adverse opinion when the auditor, having obtained sufficient appropriate audit evidence, concludes that misstatements, individually or in the aggregate, are both material and pervasive to the financial statements.

3.14 Illustrations of adverse opinion

Basis of adverse opinion

1. *The company is manufacturer of different varieties of paper and has been in lock out from 30-8-2009. The details of inventory valuation are not available with the Company. Also inventory records in respect of raw materials, finished goods, consumables, stores and spares and semi- finished goods were not made available for our verification. Hence, we are unable to verify compliance of Accounting Standard-2, Valuation of Inventories.*
2. *The Company has made scrap sale of ₹ 1,01,29,174 during the year. The nature and description of items sold as scrap was not available. Hence, we are unable to verify the correctness of these transactions.*
3. *The company has paid electricity charge and interest thereon amounting to ₹ 432.46 lakhs to Kerala State Electricity Board and shown under ''other receivables'', which in our opinion should have been charged as a revenue expenditure in the year it was incurred. (See note no.10 of the notes forming part of accounts)*
4. *According to our opinion, Trade Receivables of ₹ 1,14,12,626.46 and Advance for Fixed Assets of ₹ 6,74,923 is long outstanding and is doubtful of recovery.*

In our opinion and to the best of our information and according to the explanations given to us, and also for the effects of the matter described on the basis for adverse opinion paragraph and the annexure to the independent Auditors Report, the financial statements do not give the information required by the Companies Act, 1956 in the manner so required and does not give a true and fair view in conformity with the accounting principles generally accepted in India.

[Audit report Victory Paper and Boards (India) Ltd. for year ended March 31, 2014]

4. SA 706 Emphasis of Matter Paragraphs and Other Matter Paragraphs

Emphasis of matter paragraph

4.1 If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report, stating clearly whether such matter is subject matter of modification or not.

4.2 Circumstances in which Emphasis of Matter paragraph may be necessary includes:

- When a financial reporting framework prescribed by law or regulation would be unacceptable but for the fact that it is prescribed by law or regulation.
- To alert users that the financial statements are prepared in accordance with a special purpose framework.
- When facts become known to the auditor after the date of the auditor's report and the auditor provides a new or amended auditor's report (i.e., subsequent events).
- An uncertainty relating to the future outcome of exceptional litigation or regulatory action.

- A significant subsequent event that occurs between the date of the financial statements and the date of the auditor's report.
- Early application (where permitted) of a new accounting standard that has a material effect on the financial statements.
- A major catastrophe that has had, or continues to have, a significant effect on the entity's financial position.
- A Scheme of amalgamation/ merger or de-merger which is affected from appointed date and previously reported numbers undergo significant changes.

4.3 If the auditor expects to include an Emphasis of Matter or Other Matter paragraph in the auditor's report, the auditor shall communicate it to those charged with governance regarding this expectation and the draft thereof.

4.4 The communication enables those charged with governance to be made aware of the nature of any specific matters that the auditor intends to highlight in the auditor's report and provides them with an opportunity to obtain further clarification from the auditor where necessary. Where the inclusion of an Other Matter paragraph on a particular matter in the auditor's report recurs on each successive engagement, the auditor may determine that it is unnecessary to repeat the communication on each engagement, unless otherwise required to do so by law or regulation.

4.5 Illustrations of Emphasis of Matter paragraphs

(a) Emphasis of Matter

We draw attention to Notes 26.1 and 26.3 to the standalone financial statements regarding remuneration of ₹ 10.66 crore paid for each of the financial years ended 31st March 2014 and 31st March 2016 to the Chairman and Managing Director (CMD) which is in excess of the limits prescribed under the provisions of the erstwhile Companies Act 1956/ Companies Act 2013 respectively and for which the Company has led an application for review/an application respectively with the Central Government; however approval in this regard is pending till date. Our opinion is not qualified in respect of this matter.

(Audit report of Hindustan Construction Company Limited for the year ended March 31, 2018)

(b) Emphasis of Matter

Attention is invited to Note No. 14(b) of the annexed financial results of the company in relation to significant decline in the net worth of Religare Finvest Limited (RFL), subsidiary of the company, adjustment of Fixed Deposit of ₹ 75,000 lakh (representing ₹ 79,145 lakh as per financial statement as on 31-3-2018) by Laxmi Vilas Bank (LVB), which is under litigation, besides concerns raised by the RBI on the operations of RFL and restriction on expansion of credit investment portfolio. Management of the RFL is in the process of taking various action including the definitive additional capital infusion plan, induction of new management personnel, discussion with RBI for relaxing the restriction imposed on the business capability of the company, initiating detailed diligence from a law firm of repute of (i) Corporate loan book and (ii) Recoverable from Strategic Credit Capital Private Limited and Perpetual Credit Services Private Limited besides strengthening the internal controls and corporate governance mechanism. Considering all these measures, management is of the view that there would be significant improvement in the financial position of RFL. Hence, decline in the net worth of RFL is considered as temporary and consequently no impairment provision has been considered necessary. Our opinion is not qualified in respect of this matter.

(Audit report of Religare enterprises for the year ended March 31, 2018)

Other Matter paragraph

4.6 Auditor adds emphasis of matter paragraph in the auditor's report pertaining to matter that is already adequately disclosed or presented in the financial statement and in auditor's judgment it is necessary to bring the matter to user's attention and thus emphasising

it by referring to that matter in the financial statements. While auditor adds other matter paragraph in the auditor's report pertaining to matter other than those presented or disclosed in the financial statements and in auditor's judgment it is necessary to bring the other matter to user's attention by giving necessary details. Other matter paragraph mainly relates to scope of audit or audit function and these matter are not subject matter of qualification.

4.7 Illustration of Other Matter paragraph

(a) Other Matter paragraph

The comparative financial information of the Company for the year ended 31st March 2016 and the transition date opening Balance Sheet as at 1st April 2015 included in these Standalone Ind AS financial statements, are based on the previously issued statutory Standalone financial statements prepared in accordance with the Companies (Accounting Standards) Rules, 2006 audited by BSR & Co. LLP., Chartered Accountants (one of the joint auditors) and G. P. Kapadia & Co., Chartered Accountants (predecessor joint auditor) for the year ended 31st March 2016 and G. P. Kapadia & Co., Chartered Accountants and Deloitte Haskins & Sells LLP, Chartered Accountants (predecessor joint auditors) for the year ended 31st March 2015, whose reports dated 25th April 2016 and 25th April 2015, respectively, expressed an unmodified opinion on those Standalone financial statements, as adjusted for the differences in the accounting principles adopted by the Company on transition to the Ind AS, which have been audited by us. Our opinion is not modified in respect of this matter.

(Audit report of Ultratech Cement Limited for year ended March 31, 2017)

(b) Other Matters

We did not audit the financial statements/ consolidated financial information of 2 subsidiaries, included in the consolidated Ind AS financial statements, whose financial statements/consolidated financial information reflect total assets of ₹ 1,948.08 crore as at 31st March, 2017, total revenues of ₹ 2,204.02 crore and net cash inflows amounting to ₹ 323.37 crore for the year ended on that date, as considered in the consolidated Ind AS financial statements. The consolidated Ind AS financial statements also include the Group's share of net profit of ₹ 49.61 crore for the year ended 31st March, 2017, as considered in the consolidated Ind AS financial statements, in respect of 1 associate, whose consolidated financial statements have not been audited by us. These financial statements/consolidated financial statements/consolidated financial information have been audited by other auditors whose reports have been furnished to us by the management and our opinion on the consolidated Ind AS financial statements, in so far as it relates to the amounts and disclosures included in respect of these subsidiaries and associate, and our report in terms of sub-section (3) of Section 143 of the Act, in so far as it relates to the aforesaid subsidiaries and associate is based solely on the reports of the other auditors.

(Audit report on CFS of Asian Paints Limited for year ended March 31, 2017)

5. Conclusion

The formats as suggested by mandatory standards are no doubt to be followed, the flow and draft of the audit report should be smooth, simple, reader friendly, and unambiguous. In the Indian context, considering the report on regulatory matters like CARO, ICFR, etc. the length of the audit report is something that needs to be constrained albeit without compromising on the clarity of communication.

❍□❍

Umang Gupta

GST – Boon or Bane

Abstract

Traditionally, India's tax regime has relied heavily on indirect taxes.

GST is undoubtedly a revolutionary reform which was long pending in the country. India is by no means the first country to experiment with a unified taxation regime.

More than 160 countries have successfully implemented different versions of the Goods and Services Tax.

What makes GST in India special is that the Union and State Governments will jointly administer India's dual GST system. It is expected to iron out wrinkles of existing indirect tax system and play a vital role in growth of the Indian economy. It is a comprehensive tax system that will subsume all indirect taxes and unify the economy into a seamless national market.

GST, with its initial implementation challenges, is a *"bitter medicine for the country which will achieve tremendous results and be a great boost for growth in the long run."*

Albeit initial hurdles and technical glitches, the transition to the GST regime has been fairly smooth in most of the industries. The GST Council in its recent meetings has rationalised the rate structure for products and addressed the problems faced by the industry. The GST Council has simplified the compliance mechanism and the return filing process which is a real positive for the country and undoubtedly GST is a **BOON** for the economy.

Keywords

Goods and Services Tax, Models of GST, Indirect tax, GST Council

Index

Introduction

"At the stroke of the midnight hour, when the world sleeps, India will awake to life and freedom.''

– Jawaharlal Nehru[1]

These words perfectly describe India's biggest tax reform since 70 years of Independence - The Rollout of the Goods and Services Tax on the midnight of July 1.

The Nationwide GST has brought in **Freedom** for 1.3 billion people of our country **– freedom** from multitude of various torturous overlapping Taxation Laws whose levy varied from State-to State, with complex legal provisions hampering growth of the economy, **freedom** from cascading effects of taxation, freedom to conduct business with ease, **freedom** from excessive, complicated and time consuming business compliances, freedom from tax terrorism, **freedom** to foreign investors to invest in India, **freedom** to consumers to increase their standard of living, **freedom** to Government to administer taxation system systematically and bring about "One Nation, One Tax, One Market"

In the words of Mr. Narendra Modi **"GST means Great Steps towards Transformation and Transparency"** and the GST Rollout is indeed a revolutionary reform in the history of our country.

Goods & Services Tax Law in India is a comprehensive, multi-stage, destination-based tax that is levied on every value addition. GST is expected to bring together State economies and improve overall economic growth of the nation.[2] Goods and Services Tax (GST) is most ambitious and biggest tax reform plan, which aims to stitch together a common market by dismantling fiscal barriers between States.

Former President Pranab Mukherjee called the GST a **"disruptive change"**, a consensus between the Centre and States, an effort "from persons across the political spectrum who set aside narrow partisan considerations and put the nation's interests first".

Studies on GST – An Insight

1. Dr. R. Vasanthagopal (2011)[3] studied,"GST in India: A Big Leap in the Indirect Taxation System" and concluded that switching to seamless GST from current complicated indirect tax system in India will be a positive step in booming Indian economy.

2. Nishitha Gupta (2014)[4] in her study stated that implementation of GST in the Indian framework will lead to commercial benefits which were untouched by the VAT system and would essentially lead to economic development.

3. Pinki, Supriya Kama and Richa Verma (July 2014)[5] studied, "Goods and Service Tax – Panacea For Indirect Tax System in India" and concluded that the new NDA Government in India is positive towards implementation of GST and it is beneficial for Government and consumers.

4. Saravanan Venkadasalam (2014)[6] has analysed the post effect of the Goods and

1. Tryst with Destiny" was a speech delivered by Jawaharlal Nehru, the first Prime Minister of independent India, to the Indian Constituent Assembly in The Parliament, on the eve of India's Independence, towards midnight on 15th August 1947, *Following the Equator (1897)*
2. Definition of GST as per ClearTax
3. Dr. R. Vasanthagopal (2011), "GST in India: A Big Leap in the Indirect Taxation System", International Journal of Trade, Economics and Finance, Vol. 2, No. 2, April 2011
4. Nishita Gupta (2014), "Implementation of GST in the Indian Framework"
5. Pinki, Supriya Kama, Richa Verma (2014), "Goods and Services Tax – Panacea For Indirect Tax System In India", "Tactful Management Research Journal", Vol. 2, Issue 10, July 2014
6. Implementation of GST: An Analysis on ASEAN States using Least Squares Dummy Variable Model (LSDVM) - Saravanan Venkadasalam

Services Tax (GST) on the national growth on ASEAN States using Least Squares Dummy Variable Model (LSDVM) in his research paper. He stated that seven of the ten ASEAN nations are already implementing the GST.

"India on Cusp of Revolution with GST" – French Economist ***Guy Sorman***

Analysis

All the four studies and research done by eminent economists and analysts point out to the Global success of GST implementation especially in developing countries with economic conditions similar to our country which is indeed a promising sign for India. The studies emphasize on the **seamless flow of input credit** under GST and suggest that there should be a proper revenue sharing model in place between the **Central and State Governments** which is something really important for a country like India.

The extent of benefit mainly depends upon the implementation, design and proper administration by the Government. With the India growth story becoming a reality, macro factors being really positive, political stability at the Centre under the leadership of Modi, July 2017 was the ideal time to rollout GST. GST will undoubtedly improve the **"Ease of Doing Business"** in India and promote the **"Make in India"** and **"Digital India"** initiatives of the Government by reducing the **"tax gundagiri"** in the country and drastically reduce bureaucracy in the country.

Timeline of GST – A Brief History

"If you don't know history, then you don't know anything. You are a leaf that doesn't know it is part of a tree"

— Michael Crichton

Let us understand the sequence of events which led to the Birth of Goods and Services Tax in India.

- GST was first mooted by Dr. Manmohan Singh in the mid-1990s
- The GST was recommended by the Kelkar Task Force on FRBM Act in 2005
- In 2011, the Constitutional (115th Amendment) Bill was introduced in Parliament to enable the levy of GST.
- In December 2014, the Constitution (122nd Amendment) Bill was introduced in Lok Sabha
- The Bill was passed by Lok Sabha in May 2015 and referred to a Select Committee of Rajya Sabha for examination
- On June 14, 2016, the Ministry of Finance released draft Model Law on GST in public domain for views and suggestions
- GST Bill Passed in Rajya Sabha on 3rd August 2016 (3-8-2016) On August 3, 2016, the Constitutional (122nd Amendment) Bill, 2014 was passed by Rajya Sabha
- In 2017 – Four GST related Bills become Act following President's assent & passage in Parliament.
- July 1 2017 – ***"And suddenly you know…. it's time to start something new and trust the magic of beginnings."***

Finally the Goods and Services Tax was rolled out in the country on July 1, 2017. Rightly said by Narendra Modi –

"GST is a result of our collective effort. Reaching a consensus for GST wasn't easy."

The rollout of the GST symbolises a **unity** amongst the diverse people of the country where all the political parties kept their political interests aside and came together for national integration and prosperity. Successful rollout of the GST in the world's largest democracy sends a very powerful message of our ability to bring about structural reforms of such magnitude. It signifies our commitment to simplify the

taxation laws in the country and promoting good governance in the country.

"Badal jao waqt ke saath ya phir waqt badalna seekho majboorion ko mat koso har haal mein jeena seekho."

Lessons from the World – Other Countries Implementing GST

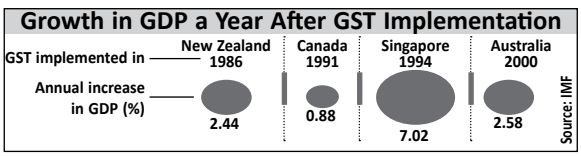
"If you want to be successful, find someone who has achieved the results you want and copy what they do and you'll achieve the same results." [1]

— Tony Robbins

France was the first country to implement GST to reduce tax – evasion. Since then, more than 150 countries have implemented GST with tremendous success. It has been a part of the tax system in Europe for the past 50 years and is the preferred form of the indirect tax in the Asia-Pacific region.

India has adopted the **Canadian Dual GST Model** with tax revenue being distributed between the Central and State Governments.

Due to removal in cascading effect of taxation and simplification of compliances, the GST Mechanism improves the growth in GDP of the nation. The same is portrayed by the chart as per a report published by the International Monetary Fund.[7]



The table given below shows the implementation of GST by various other Asian countries with similar economic environment and growth story as that of India.

Table 2: List of Asian Countries Implementing VAT/GST[8]

No.	Country	GDP Per Capita (World Bank, 2011, USD)	Year of Implementation	Current Rate (%)
1	Bangladesh	743	1991	15.0
2	China	5,445	1994	17.0
3	India	1,509	2005	12.5
4	Iran	NA	2008	5.0
5	Japan	45,903	1989	5.0
6	Jordan	4,666	2001	16.0
7	Kazakhstan	11,357	1991	12.0
8	Kyrgyzstan	1,124	1999	20.0
9	Lebanon	9,413	2002	10.0
10	Mongolia	3,129	1998	10.0
11	Nepal	619	1997	13.0
12	Pakistan	1,189	1990	16.0

The successful implementation of the Goods and Services Tax by our neighbours is a very positive cue for us.

"Learning from your mistakes is smart, Learning from other's mistakes is wise."

This is exactly what our lawmakers have done.

Before drafting our GST Model draft, we studied the GST implementation in several countries and the problems faced by them. And we modified and adapted the GST laws to suit the Indian economic and political conditions.

7. Report Published by IMF on impact of GST on country's growth
8. Table as published on GST Seva.com

The Indian GST Model

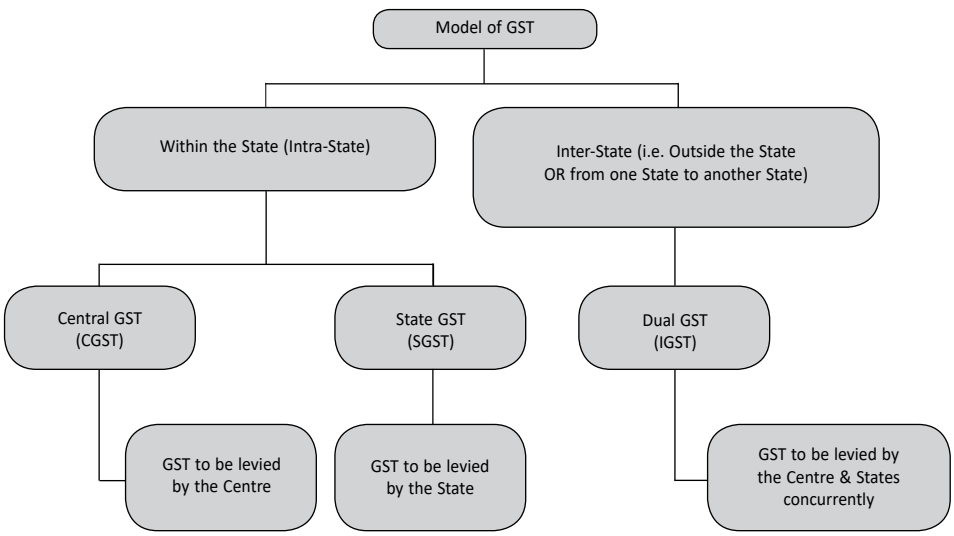
One Nation One Tax

Table: Taxes at the Centre and State level Are Being Subsumed Into GST.

S. No.	At The Centre	State Level
1	Central Excise Duty	a. Subsuming of State Value Added Tax/ Sales Tax
2	Additional Excise Duty	b. Entertainment Tax (other than the tax levied by the local bodies), Central Sales Tax (levied by the Centre and collected by the States)
3	Service Tax	c. Octroi and Entry tax
4	Additional Customs Duty commonly known as Countervailing Duty and	d. Purchase Tax
5	Special Additional Duty of Customs	e. Luxury tax, and

The above table shows list of taxes centre and state level are being subsumed into GST which brings about "One Nation, One Tax, One Market." This step undoubtedly reduces compliance costs for businessmen and is a very revolutionary step in our country subsuming more than 40 taxes into one Goods and Services Tax.

The Basic GST Model



In a federal country like India where the power to tax domestic trade is divided between the Central Government and the State Government, the designing of a destination based GST becomes extremely complicated.

A **conventional national** GST **cannot** be implemented without the States losing their fiscal autonomy.

Considering the basic framework of the Constitution and keeping its structure intact, **Dual GST** appears to be the best possible solution for the Indian scenario.

India has adopted a Dual GST model where Tax is levied by both the Central and the State Government. This system minimises the disputes between Central and State Government on the Revenue Sharing issue, a problem which is highly prevalent in a country like India.

This will also bring about a decrease in effective tax rate and increase the tax collections due to a wider tax base and better tax compliance.

Benefits of the Goods and Services Tax

1. No More Cascading Effect of Taxes

In the erstwhile regime of indirect tax system, the chain of input credit, at a certain point, was getting broken and there were barriers to seamless flow of credit. Cascading tax effect can be best described as 'Tax on Tax'.

The traders did not get the input credit of Excise Duty paid on goods purchased to set off their output VAT liability on sales and hence excise duty became a part of the cost of the product which led to a cascading effect of taxation i.e., VAT was imposed on final amount (Cost of Product + Excise Duty) which led to **taxes being levied on taxes** leading to a compounding effect.

Moreover, the businessmen were not getting input credit of CST paid on inter State purchase of goods and Swachh Bharat Cess paid on Service Tax which was leading to a break in the input credit chain and thus adding to the cost of the final product.

PRE GST

Manufacturer	
Basic Cost	1,00,000
Excise + Cess (10%)	10,000
VAT @ 10%	11,000
Total	1,21,000

Distributor	
Distributor Cost (Basic + ED)	1,10,000
Margin @ 20%	22,000
Price before Tax	1,32,000
VAT @ 10%	13,200
Final Price to customer (including 10% VAT)	1,45,200

POST GST

Manufacturer	
Basic Cost	1,00,000
CGST @ 10%	10,000
SGST @ 10%	10,000
Total	1,20,000

Distributor	
Distributor Cost (Basic + ED)	1,00,000
Margin @ 20%	20,000
Price before Tax	1,20,000
CGST @ 10%	12,000
SGST @ 10%	12,200
Final Price to customer (including 10% VAT)	1,44,000

Post GST Price to customer = 1200 cheaper

Source: *https://www.greengst.com/how-does-gst-eliminate-tax-on-tax/*

Let us take the example of a motorcycle manufacturer, Rhonda Motorcycles.

In the old tax regime Rhonda motorcycle sells motorcycle to its distributor Dev Automobiles at Basic Cost Price of ₹ 1,00,000 and current tax of 10% Excise + Cess and 10% VAT.

Here, after 20% margin and 10% VAT to the customer, Dev Automobiles sells the motorcycle to end consumer in same State at ₹ 1,45,200.

Let us now assume that post GST, the overall taxes continue to remain @ 20%. Once GST regime comes in excise duty and cess will be replaced by GST, and therefore it will be allowed to be set off against supplier's liability.

Now, Dev Automobiles will be able to sell the same motorcycle to the end consumer at ₹ 1,44,000.

Therefore, the end consumer gets benefitted through the levy of GST which leads to a seamless flow of credit and stops the cascading effects of taxation.

2. Lower Compliance Costs

"In a society which did not conventionally mind being a non-tax compliant one, people are realising the virtues of compliance which comes with passage of time. This is the reason for tax integration."

— Arun Jaitley

All tax payer services such as registrations, returns, payments, etc. would be available to the taxpayers **online**, which would make compliance easy and transparent. GST will be supported by a robust IT network-GSTN-which would be the foundation of GST regime in India.

This has been beneficial for start-ups especially, as they do not have to run from pillar to post to get different registrations such as VAT, excise, and service tax.

Lower Number of Compliance

Earlier, there was VAT, Excise, Octroi, Entry Tax, Works Contract Tax and service tax, each of which had their own tedious returns and compliances which increased cost of doing business. Below table shows the same:

Tax	Return Filing
Excise	Monthly
Service Tax	Proprietorship/Partnership – Quarterly Company/LLP – Monthly
VAT	Different for different States Some States require monthly returns over a threshold limit. Some states like Karnataka require a monthly return

Source: Clear Tax

GST Return Relief – Quaterly Returns for Small Businesses

To ease compliance for small businessmen, **businesses with a turnover of up to ₹ 1.5 crore need to file GSTR-1 on a quarterly basis** as per the announcement after the 23rd GST council meeting on Nov. 10, 2017.

"The relief provided to taxpayers by making the simplified form of 3B available till March 2018 and only the details of outward supplies in form 1 indicates that the Government has realised that compliance problems were marring the acceptability of GST."

— M. S. Mani, Partner (GST) at Deloitte India

3. Higher Threshold for Registration

"A higher threshold of ₹ 20 lakh is a good news. Many small scale traders and service providers would be saved from undertaking GST compliances and it also reduces a substantial burden for tax authorities to assess small time dealers. Numerous little scale merchants and specialist co- ops would be spared from undertaking GST compliances and it additionally lessens a considerable weight for duty experts to survey little time merchants."

— Rajeev Dimri, Leader, Indirect Tax, BMR Associates

Old Regime
Earlier, in the VAT structure, any business with a turnover of more than ₹ 5 lakh (in most States and ₹ 10 lakh in some other States) was liable to pay VAT. Also, service tax was exempted for service providers with a turnover of less than ₹ 10 lakh.

Under GST Regime
Under GST regime, however, this threshold has been increased to ₹ 20 lakh (for, North Indian States and Sikkim, the exemption would be ₹ 10 lakh), which exempts many small traders and service providers.

Benefit
So this reduces the unnecessary compliance burden on small businessmen who are forced to incur high costs for return filing and other GST formalities and this would ultimately lead to ease of doing especially business for small businessmen. The operating costs will come down drastically and this would promote foreign investment into the country.

Threshold Limit for GST Registration

Businesses with the following annual turnover limit should register for GST

North Eastern States	Rest of India
9 lakh or more must register for GST	**19 lakh** or more must register for GST
10 lakh or more must file GST	**20 lakhs** or more must file GST

4. Reduction in Corruption

"In a state where corruption abounds, laws must be very numerous"

— Tacitus

The famous quote of the popular Roman Senator Publius Tacitus rightly summarises the Indian indirect tax regime and the corruption in the country. The multiple taxation laws was the root cause of high levels of corruption in India.

GST is the best tool to reduce corruption and increase Government efficiency through technology
Corruption in a tax department is directly proportion to the tax evasion.

"Corruption is worse than prostitution. The latter might endanger the morals of an individual, the former invariably endangers the morals of the entire country."

If businessmen can't evade taxes, they would also not bribe the tax officials for corrupt practices.

Reasons

- **Reduced Net Taxes**

The taxpayers shall be eligible to take credit of the taxes on all the inputs across India, which would reduce his net tax liability.

- **Reduced Interface**

All the returns of the taxpayers shall be filed online in the GST regime. They would also get all their refunds, orders etc. online. This will reduce the interface between the assessees and officers, which would reduce corruption

- **Greater Transparency**

The GST Network (GSTN) is designed to capture all transaction details up to invoice level. The paper documentations are to be eliminated completely.

- **Dual Control**

GST will be monitored jointly by Central and State Government officials. It would be difficult to manage some officers and do evasions. The chances of getting caught would be double in the GST regime. Hence, the GST regime is likely to improve tax compliance and reduce corruption.

5. Lower Tax Evasion

"Manmaana Tax ab hoga band,
Tax choriyan bhi hongi kam,
GDP ko hamari lagenge pankh,
Sapnon ke bharat ka hissa honge hum."

Any trader after GST will not be able to sell products or goods without bills. Once a bill exists in the system, scope for black money reduces automatically.

The taxpayers shall be eligible to take credit of the taxes on all the inputs across India, which would reduce his net tax liability.

Thus, most taxpayers would therefore avoid evasion in GST regime.

"So far, it was voluntary compliance without anti-evasion measures. It is important to build anti-evasion measures and e-way bill is an important anti evasion measure...collections will pick up."

— Arun Jaitley, the Finance Minister.

The mandatory paper trail that GST will create will go a long way in improving tax compliance. Bringing sectors like real estate and precious metals such as gold sectors within the ambit of GST will help curb black money generation in these sectors.

"Due to GST, various indirect and hidden taxes have ceased to exist. The biggest beneficiaries of GST will be the consumers, middle class," said the Indian PM Narendra Modi.

GST will help in curbing domestic black money. Though it is a reform for indirect taxes, there are filers who understate incomes by not reporting each and every transaction.

By doing this, they save excise, VAT, Octroi etc., and more importantly, are able to furnish under reporting of their incomes.

Sectoral Impact of GST

1. Real Estate Sector

The real estate sector is expected to become more transparent, since the introduction and implementation of GST. GST will absorb many of the indirect taxes developers had to pay under the previous regime. These reductions for the developers will positively impact buyers, as costs will decrease.

Tedious and Complex Taxation in the Old Regime

Since VAT, stamp duty and registration charges were State levies.

Service tax was a Central levy and was charged on construction. So the calculation of taxes was very tedious and complex in the earlier regime.

Impact of GST on various types of properties

– Under-Construction & Ready to Move Property

Under GST, all under-construction properties will be charged a flat rate of 12%. However, GST is not applicable on sale of ready-to-move in properties.

– Affordable Housing

Projects under affordable housing scheme (including under-construction properties) are exempted from GST. This exemption is mainly given to support Prime Minister's initiative of "Housing for all by 2022".

–- Property Taken on Rent

Property taken on rent attracts GST at 18% with full Input Tax Credit which is positive for the sector.

"Instead of paying various taxes, at various States and cities, it would be just one tax that is going to benefit. In the process, lot of labour and money will be saved. Taxes will be in line with the standard of the absorption of the industry and in the real estate sector. If all that can be reduced then it's a big advantage".

— Mr. Diipesh Bhagtani, Chairman (Exhibition) – CREDAI-MCHI,

In a Nutshell:

- GST will simplify the earlier complicated tax structure.
- Reduce costs for developers by way of input tax credit.
- Buyers will benefit from the input tax credit, by way of paying GST on lesser amount.
- Affordable housing will get a push and we can expect more projects being launched under such schemes.
- With better regulations like RERA and GST coming into force, we can expect better transparency, management and increased buyer confidence in Real Estate sector.

2. Pharma and Healthcare Industry

"As far as the healthcare and particularly the pharma industry, we expect that the GST legislation will benefit the customers by making health care affordable."

— Ramesh Swaminathan, CFO of Lupin

Industry Background

The Indian Pharmaceutical industry is currently the largest producer of generics in the world and the 3rd largest when talking about volume. It accounts for almost 5% of the country's GDP and is expected to touch 150 billion dollars, by the end of the year. Seeing this exponential growth, the impact of GST on the sector is going to be quite significant.[8]

Pricing Impact

In terms of pricing, GST's net impact will be price neutral in most of the states for the pharma industry in general.

"This is a breakthrough tax reform and one of the biggest major milestones for the country and its industries. We are confident that the GST bill would boost the local manufacturing sector, enable more accessible to products which will be affordable for the local consumers and will give a momentous boost "Make in India" specifically in the healthcare sector."

— Rekha Ranganathan, GM, Mobile Surgery, IGT Systems Philips HIC

Streamlined Tax Structure in Pharma Sector under GST

GST is set to benefit it majorly by streamlining the tax structure. Under the past tax regime, there were about eight indirect taxes levied

9 https://www.greengst.com/gst-impact-healthcare-industry-pharma-sector-india/

on the Pharma industry. By subsuming all these taxes, GST will also help facilitate the streamlining of store network, which in itself can add 2% to the market measure of the industry.

Reduction in Assembly Cost
Furthermore, with the discontinuation of the CST (Central Sales Tax), GST will reduce the assembling costs, also enhancing operational effectiveness by merging warehousing methodology, for most companies.

3. FMCG Sector

"We believe it could result in a faster consumption shift from unbranded to branded products, spurring volume growth for FMCG companies. Simultaneously, it will also bring operational efficiency with rationalization of supply chain by removing bottlenecks."

— Sanjay Manyal, Analyst, ICICI Securities

Industry Overview
Fast-moving consumer goods are popularly known as consumer-packaged goods. It is the fourth largest sector of the Indian economy which has witnessed the change that GST has made. FMCG is also one of the fastest growing sectors of the economy. The sector consists of more than 50% of food and beverage industry and around 30% of personal and household care thereby including the entire urban as well as rural parts of India.

Reduction in Warehouse Cost
Earlier, due to State-wise taxation the warehouses were set up usually in the States where the effective tax was low. With the implementation of GST in the country, now the FMCG companies can set up their warehouses wherever they want without any difficulty due to "One Nation, One Tax."

Logistics Cost Saving
GST is proving to be beneficial for the FMCG sector as the industries are saving a fair amount of logistic expenses. Earlier, during the pre-GST regime, the distribution cost on the FMCG sector was charged at 2 to 7 percent, which has now been reduced to only 1.5 per cent after the GST implementation.

Mixed Impact on Taxation Rate
The effective tax rates have increased on some products, especially on aerated products and beverages which will now attract 28% GST in addition to 12% cess. This has had an immediate impact in the form of increased cost of these sweetened aerated water and related products.

Even Ayurvedic Products are being taxed at a rate higher than expected given the fact that the Government was heavily promoting traditional Indian medicines.

Tax rates on products like edible oils and hair oils have decreased.

But overall the rate impact on most of the other products is neutral and the long term outlook of the industry is seen to be really robust.

4. E-Commerce Industry

Industry Overview
E-commerce or electronic commerce (an online shopping hub) manages the buying and selling of products and services exclusively through electronic channels. E-commerce captures around 33% of the global market with a positive growth in near future. The report of Internet and Mobile Association of India claims that India is expected to generate $100 billion online retail revenue by the year 2020.[10]

"We believe GST is good for the e-commerce industry as it would eliminate hurdles in inter-State delivery and subsume the entry tax introduced on e-commerce

10. ClearTax

shipments by some States," an Amazon India spokesperson said.

GST Special Provision for the Sector -

1. **Tax Collection at Source (TCS)**
   It is mandatory for all e-commerce operators to collect tax at the rate of two per cent as TCS on the net value of sales made by suppliers through e-commerce operators.

   The key purpose of this provision is to encourage compliances under GST and provide a mechanism for the Government to track suppliers who sell through e-commerce operators.

2. **No Benefit under Composition Scheme**
   GST law has explicitly excluded e-commerce businesses from the composition scheme.

3. **Increase in Input Tax Credit**
   The GST law has extended the meaning of 'input tax' to cover any goods/services used by the company in the course of business, which has widened the ambit of input GST credits. This has removed the requirement to establish the direct nexus of inputs/input services with the final product/service provided by companies.

"In the GST regime, the vendor has to pay GST and instances of holding e-commerce companies responsible for vendors' tax payment will come down. In general, GST introduction is good for e-commerce companies as GST is a destination-based tax on consumption, unlike central sales tax on inter-state sale of goods which is origin-based,"

— Pratik Jain, leader, Indirect tax, PricewaterhouseCoopers India

Conclusion
Overall the implementation of the Goods and Services Tax is a big positive for the sector in the long run albeit short term compliance challenges.

The long term benefits outweigh the initial challenges and hiccups for the sector. Digital India is the most celebrated agenda of the Government of India.

GST and e-commerce trade both have the potential to disrupt the market in the most positive way, provided the attitude of the stakeholders is towards acceptance and adaptability.

5. Automobile Industry

Industry Overview
Automobile industry in India is one of the most successful and emerging manufacturing industry post liberalisation. The industry has potential to grow and become a major contributor for the economic development and employment creation.

"GST will be positive for the automotive sector, primarily because of the efficiency and the removal of cascading."

— CNBC-TV18

Tax Rate on Vehicles
Automobiles have been kept under the 28% tax bracket. The changed tax structure has different implications for different types of vehicles.

In a Nutshell

1. A marginal change in the tax on commercial vehicles
2. Sizeable cost reduction in small vehicles and SUVs

This will directly benefit the middle-class sector as the decreased impact of taxation will be passed on to the end consumer through reduced prices of vehicles.[11]

11. Tata Motors Report on how GST will affect the Automobile Industry

Benefits of GST on the sector

1. **Uniform Prices across the country**
   With the GST rates of taxation being the same across the country, there will be no differentiation of tax cost for the consumer when procuring the vehicles from another State.

   This will reduce incidences of tax evasion which occur due to consumers buying vehicles from States other than where they reside.

2. **Seamless Input Credit**
   In the automobile sector, a car is manufactured in a particular State and generally, 80 per cent of these cars are sold to States outside the State of manufactures to dealers outside the State.[12]

   So in the pre-GST regime, Inter-State purchase and sale of cars and auto components attracted a 2% CST which was a cost to the manufacturer which was ultimately passed to the consumer. However now full credit of IGST would be available which would certainly be a great boon for the sector.

Conclusion

GST, will invariably reduce the cost of manufacturing of bikes and cars due to the subsuming of all the various taxes into a unified tax slab. Under the GST regime, taxes would be levied on the consumption State as opposed to the origin/manufacturing State, which in turn, will help give a push to the growth rate of the automobile sector.

Challenges ahead in the GST Regime

1. **Lack of skilled resources and need for reskilling**

With new GST provisions with their complexities becoming a part of our policy framework, skilled staff with updated GST subject knowledge and training are not easily available. This has placed an additional work load on personnel across industries.

Opportunity

On the flipside, it is a great opportunity for young and emerging professionals to specialise in the Goods and Services Tax and provide specialised services to their clients.

Government GST Training Programme

Recognising this the Government of India has launched a 100 hour training programme under Pradhan Mantri Kaushal Vikas Yojana (PMKVY) for CA, CS, Graduates and Post Graduates.

"Skill India will actively contribute to the new tax regime. We are going to launch GST training programme to equip the candidates with the relevant skill sets in order to be an efficient GST professional. This GST certification course will help candidates to explore wider opportunities in the job market"

— Shri Rajiv Pratap Rudy, Union Minister of State for Skill Development

12. EY Report on Impact of GST on Auto Sector

The PMKVY course will equip the candidates with the relevant skills to benefit from the job opportunities that GST will generate.

2. GST Compliance and Return Filing is Complicated

Filing three returns in a month, registration rules, complex refund rules – there are multiple compliance issues that are worrying the businesses.

This will gradually increase costs for small businesses as they will have to bear the additional cost of hiring experts.

This will increase the operating costs for businesses and hamper the "Ease of Doing Business in India."

Government Measures to solve the problem

As per decision of the 23rd GST Council Meeting, taxpayers with an annual aggregate turnover up to ₹ 1.5 crore in the previous financial year or anticipated in the current financial year can avail themselves of the option of **filing quarterly returns**.

The Government has also simplified the return filing forms to help the taxpayers.

Also, the GST Council plans to combine the 3 GST return forms – GSTR 1, 2 and 3 into 1 simplified form for the benefit for the taxpayers.

The Reverse Charge Mechanism under the GST which was also creating a lot of confusion amongst the taxpayers has also been deferred by the Government

This is a major relief for the small and medium businessmen.

3. Technical Glitches on the GSTR website

"Most of the time the portal gets hanged and traders cannot log in. Moreover, whenever it was in operation it shows errors and details of errors are not visible," said a spokesperson of Confederation of All India Traders.

The GST website initially faced some hiccups due to network overload attracting the anger and frustration of the taxpayers and the GST professionals due to software glitches.

"There are many technological issues in the network such as the logging-in problem. Some traders who have transitioned to GST and have received their temporary numbers to log in are unable to do so because the network is busy."

— Rahul Mehta, President of the Clothing Manufacturers' Association of India

Government action

Deadlines Pushed Back

The GST Council was quick to identify the problems and took the suitable step of extending the due date for Return filing which is undoubtedly in the taxpayer's interest.

Solving the Software Issues

The Council revamped the website and solved the technical glitches and the situation has now improved drastically. The Government is now all set for a successful country wide rollout of the e-Way Bill which is the heart of the GST mechanism.

Responsive to Taxpayers Complaints

Throughout the implementation phase the Government has actively redressed taxpayer's grievances through the GST Twitter handle, the chat facility on the GST Portal and the telephone helpline numbers.

4. High Taxation Rates on various products

The Goods and Services Tax was criticised due to very high taxation rates. GST was criticised as it would affect the consumers and cause widespread inflation in the country due to unduly high rates.

Government Response

The Government realising the problems faced by the industry has continuously been reducing GST rates on various products in its GST Council Meetings.

"All our decisions are people-inspired, people-friendly and people-centric. We are working tirelessly for India's economic integration through GST."

— Honourable Prime Minister Narendra Modi

"There was unanimity that in the 28% slab, there should only be the so called sin and demerit goods (the consumption of which is discouraged through high tax rates). So, today the council took a historic decision to retain only 50 items in the highest slab and to bring down the rate on the rest to 18%," said Bihar deputy Chief Minister Sushil Kumar Modi after the GST Council Meeting on 10th November 2017.

Jammu and Kashmir Finance Minister **Haseeb Ahmed Drabu** said that tax rate rationalization was a continuous process.

5. Disputes between the State and Centre over the Revenue Sharing

Initially there were lots of disputes and arguments about the revenue sharing formula between Central and State Governments and there was lot of resistance from the manufacturing states.

Rollout of the GST

"I am happy at the fact that when it comes to enforcing GST Bill all political parties came out in one voice,"

— Finance Minister, Arun Jaitley

The disputes were solved on Revenue sharing and all the States agreed on the revenue sharing model as proposed by the GST Council.

Dual System of GST

The Dual System of GST is ideal for a country like India where a Centralised levy would imply the States losing out on their fiscal autonomy in levying and collection of taxes.

There the GST task force had recommended India to adopt the Dual GST Model.

Conclusion

GST aaya, GST aaya,
Poore desh mein parivartan laya
Service Tax, VAT, Octroi sabko isne niptaya,
GST ne naya dhamaal machaya.

Goods and Services Tax (GST) is most ambitious and biggest tax reform plan, which aims to stitch together a common market by dismantling fiscal barriers between States.

GST can also be used as an effective tool for fiscal policy management if implemented successfully due to nation-wide same tax rate. Its execution will also result in lower cost of doing business that will make the domestic products more competitive in local and international market. In long-term it will lead to higher output, more employment opportunities and flourish GDP of the nation.

Though the economy has faced implementation hurdles in the initial phases due to technical and design issues in the form of website login errors, confusion over reverse charge mechanism, frequent rate changes and postponement of the much awaited e-Way Bill, however *the response of the GST Council has been responsible and encouraging.*

The Council has simplified the compliance mechanism in the form of quarterly returns for small businessmen, simplification of the return forms, rate reduction for many products, and increase in the threshold limit for composition scheme etc.

This revolutionary reform has increased the confidence of the foreign investors in the Indian economy and this was reflected in improvement in India's rating in "Ease of Doing Business" The initial results of GST have been quite positive and the Government needs to keep focusing on further simplifying the System and address the industry's concerns over implementation hurdles.

In a Nutshell, "GST is the Best Possible thing which could have happened to the Indian Economy" and the ability to bring about such a revolutionary change by the world's largest

democracy reiterates our bright future in the years to come.

And I conclude with the following lines –

Modiji ki Iss soch ko hum salaam karte hain
Doston GST se nahin ghabrana hai
Isse apnakar vyapaar badhana hai.

GST Bill ka karo swagat
Isse milegi arthavyavastha ko taaqat
Poore desh mein ek hi tax
Naam GST aur Desh apna banega best.

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CA Dinesh Tejwani

TECHnovation

Challenges of Handling Tax Procrastinators

Every tax practitioner has a tough time during the return filing period. The biggest challenge is bunching together a large number of returns at the last moment.

According to IRS, during 2017, 11% of the total returns were filed during the last week and 21% of the total returns in the last 2 weeks. In India, I could not find similar statistics for recent years. But a report for 2013 says out of total 1,03,21,775 returns filed 11,63,475 returns were filed on 31/07/2013 i.e. the last day. This works out to 11% returns filed on the last day !!

Psychologists come up with several reasons for procrastination like perfectionism, waiting = excitement, lack of discipline, working best under pressure etc. Tax filers come up with more reasons to delay filing i.e., no motivation, burdensome activity etc. The fact is such a delay on the part of clients causes a huge stress on tax practitioners.

Since this problem is global in nature, I thought of looking at it from viewpoints of three different geographies. I am presenting three case studies on this subject, one each from Australia, India, and the USA. These are based on a webinar by CA Prashanth K L (organised by CTC) and detailed interview with Martin and Paridhi. These are not supposed to be representative case studies but illustrative. Each of us can and may have found our own unique way of managing the challenge.

 # 1: The challenges of collecting information from clients

To begin the return filing process, the first main challenge is getting the required information from clients in a complete and timely manner. These are:

- Not getting information and need to send constant reminders
- Getting information in bits and pieces
- Getting several versions of the same file

 # 2: The challenges of organising data and complete filing

Once information has been received, the next challenge is to organise the information systematically, so that a team of people can work on it and retrieval is fast and easy.

- Storing data so that retrieval is fast
- Assigning tasks to teams
- Tracking completion and correctness of filing

To understand these challenges and how tax firms are devising ways to handle them, let us now look at three case studies.

Case Study: Australia

Martin Artenstein is the director at Morris Cohen, Glen & Co, a CA firm from Australia with offices in Sydney and Melbourne.

Martin believes in educating clients about giving complete and timely information and the consequences of late compliance requirements, such as penalty, general interest charges and possible legal actions.

The firm prepares a schedule to ensure clients are complying with the filing due date. "We set a start date and an estimated end date to complete the returns. This estimated time frame allows us to ensure that we can get all the information required from the clients timely. We also communicate the estimated time period to our clients so that they have the same expectations as to when the return will be completed and submitted to the Tax Department."

Each client is provided with a check-list of information required from them. Usually, clients follow the check-list and send complete information. Clients have to be chased to get information. "We regularly contact clients by sending an email reminder and if they do not reply, we contact them via phone or mail."

Most clients send data via email or by uploading on a cloud server like Google Drive. "But some clients use portable discs or USB. Few others prefer to send information by snail mail which is usually handwritten!!"

About clients sending multiple versions of the same files, Martin believes in educating clients and informing them of the consequences of sending multiple files, which could be

- Not using the latest versions and having to redo the filing
- Reviewing multiple versions to decide if these are identical or calling them to confirm which one is correct will result in more time and consequently higher billing

About technology, they use MYOB AE which assists them with planning, the filing of returns, preparation of financial statements, workflow management, time sheets and billings. They also encourage clients to use cloud-based accounting so that they can access it independently.

What will interest all of us, is their practice of using the current year filing experience to educate client for the next year.

"When we process data and returns, we prepare notes for clients and accountants who will attend the job in the next financial year. When the job is done, we educate clients in order to avoid the above risk and also mitigate unnecessary work. This informs both the clients and accountants what they have to look out for when completing the next financial returns."

Case Study: India

Prashanth K L is a partner of CA firm: Guru and Jana, Bangalore. In July he conducted a very interesting webinar on this topic for the Chamber and experience and solutions given below are based on the webinar contents.

Prashanth feels that there is no inspiration for clients to file the return on time, so the filing gets delayed till last moment. To drive home the point, they have done something unique. They prepare a return with complete details and visit the income tax office on April 1 at 10 AM and present it to the officer. One may ask when electronic filing is mandatory what purpose a paper return would serve? It is a demonstration of fact that return can be filed on April 1 and need not be delayed. They are proud of this fact and call it "First in a Billion", i.e., the first to file the return in a country of over a billion people.

Second most important point is communication with the client and setting expectations right. They educate client right in the beginning as to the scope of work, change in law needing

additional information as compared to previous year, need for timely submission of complete data etc. Prashanth feels, several times, tax practitioners also keep asking data in bits and pieces, which may irritate the client. So they keep a comprehensive and complete checklist (customised for each customer's requirement). They also educate clients to record and analyze their financial data in order to file the return on time.

Third most important point is using technology, standard practices and paperless office to achieve timely and error-free filing.

- Sharing checklist with clients via Google spreadsheet, so that everyone is aware of information received/pending
- Using a web-based application *Papilio* to organize teams, manage workflow and store documents
- Proper assignment of work to juniors and involving them with client interaction, so that client does not always expect a partner to respond

About a paperless office, Prashanth says their firm has an interesting challenge for the staff, it is a One-Minute Challenge to retrieve any information/document. If an information cannot be retrieved in under one minute, then it is not properly stored.

Case Study: USA

Paridhi Jain is CEO of Seva Ltd. a Certified Public Accountants firm having offices in Baltimore, MD, and Huntsville, AL, USA.

Fortunately for her, very few clients need to be chased for information. Most provide information without much reminding. However, information still comes in bits and pieces and with multiple versions of the same file. Over the years, the firm has devised a way of getting complete information

The information gathering process begins by sending a standard checklist and tax season reminder to clients. But once data files have been shared and return preparation begins, they send an email with Yes/No option to each client to confirm completeness of data.

"Experience has shown that client-specific questions that are tailored to them, in email format, where the client needs to just answer Yes or No has been found to be the best way to get accurate and timely information but it is very time consuming."

Most clients upload information to the server, but some still send information by email. *"When reviewing, its hard to keep track of which document / email has information that needs to be in the return. We have started to save emails and keep them on the server along with changing the names of the files to keep track of reviewed documents."*

This way their firm manages all data files, queries and responses *via* email at one place.

To discourage last moment filers, they charge *"an expedited service fee* to clients who share their documents with us in the last 15 days, so that this habit can be discouraged the following year".

Paridhi believes that while a standard practice management software may have its advantages of everything being at single place, their firm is happy using different software/apps because *"each technology is geared specifically for that task, so we have advanced technology features, which one single software lacks as it ends up being the jack of all trades."*

So, they use Trello for workflow and dashboard, FrontApp for collaborating on emails and SmartVault for document management.

Paridhi feels that there is always room for more improvements and using the latest technology tools. However, it needs to be a balanced approach as *"frequent technology upgrades also end up being a strain on the firm as training all the staff in new processes takes a lot of resources."*

Key Takeaways

From the above case studies, some common points are emerging. These are:

- Educating and keeping regular communication with clients
- Using a customised checklist tailored to each client's requirements
- Using web-based workflow tools to manage to file
- Creating processes and technology to bring all data in one place securely
- Constant learning to improve the systems and processes every year

Technology Tools

Technology can play an important role, in achieving efficiency during return filing. I am giving below a few tools that can be used.

Practice Management Software

A web-based practice management software, goes a big way in proper organisation of information, documents, teams and efficient workflow. Several such software are available and one may look at them to see suitability. In the above case studies, we learnt about *MYOB*, *Papilio*. Some other Indian such software are *CCH iFirm, Jamku, CA Dashboard, ERP CA* etc.

In case you are not yet ready for a comprehensive practice management software then following tools can be used:

Trello is a collaborative task management app/software that gives you a visual overview of tasks and who is working on them, in an interesting display of digital boards. You can define workflow, checklists and several other productivity tools.

Google Docs is a free tool to write, edit and collaborate via word files or excel spreadsheets. This can be used in conjunction with Google Drive to store documents in different folders.

Rebump is a great tool to send automatic reminders to your clients. All you have to write one mail and then create "bumps", i.e. follow-up emails to be sent, if no reply is received for your mail. Since the bumps too are written by you, the whole process of reminding will look very personal to the client.

FrontApp is a shared inbox and a great collaborative tool to cut the email clutter. There is no need to mark cc, forward or reply-all. Emails can be assigned to a team member who can comment internally. One can even work in realtime to draft responses to avoid duplicate/ conflicting responses.

SmartVault is a document management software. It has a specific workflow, security and compliance requirements for tax firms.

LastPass is a very useful tool as it securely remembers all your passwords. You can even share them with your team members, without disclosing the actual password.

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> Each one of you has a glorious future if you dare believe me. If you remember what I say, think of it, and digest it, it will be yours, it will raise you higher and make you capable of understanding and living in truth.
>
> — *Swami Vivekananda*

CA Sanjeev Lalan

Unending Vows of Form No. 3 CD

Recently, the CBDT has *vide* Notification No. 33/2018/F.No. 370142/9/2018-TPL dt. 20th July, 2018 notified Income-tax (8th Amendment) Rule, 2018 whereby certain changes in Form No. 3CD relating to furnishing of certain particulars have been carried out and same shall come into force w.e.f. 20th August, 2018. In all, six changes and nine new requirements are prescribed. While some of the changes were necessary, there are some changes which go beyond the objective of the provision of section 44AB.

The scope and effect of section 44AB were explained by the CBDT in Circular No. 387, dated 6th July, 1984 [(1985) 152 ITR St. 11] in para 17. The objective stated in para 17.2 in this regards is noteworthy and same is reproduced hereunder –

"17.2 A proper audit for tax purposes would ensure that the books of account and other records are properly maintained, that they faithfully reflect the income of the taxpayer and claims of deduction are correctly made by him. Such audit would also help in checking fraudulent practices. It can also facilitate the administration of tax laws by a proper presentation of the accounts before the tax authorities and considerably saving the time of assessing officers in carrying out routine verifications, like checking correctness of totals and verifying whether purchases and sales are properly vouched or not. The time of the assessing officers thus saved could be utilised for attending to more important investigational aspects of a case."

Further, as per section 44AB, an assessee satisfying any of the five broad criteria, has to obtain and furnish the report of audit in prescribed form and set forth such particulars as may be prescribed. Thus, the primary responsibility of setting forth the prescribed particulars is that of an assessee. An auditor only has to verify the same and report upon the veracity of the same.

Thus, from the plain reading of the provision and object for introduction of the audit under the Income-tax Act, it is clear that the reporting should be confined to facts and matters requiring adjudication based on investigation should not form part of the reporting requirements under the provisions of section 44AB. And rightly so, because an auditor under the said provision is not vested with the wide powers enjoyed under the statutory audit provisions of any statute, for example Companies Act, 2013 where the powers of an auditor are expressly spelt out. In fact, such wide powers are also not available under

section 142(2A) to an auditor for the purpose of special audit.

We may proceed to discuss the amendments in light of the above discussion.

A. Changes in the existing clauses

a. Clause 4: Liability to pay indirect taxes

Under this clause registration number or identification number has to be provided by an assessee who is liable to pay indirect taxes like excise duty, service tax, sales tax, custom duty etc. In this list of taxes, GST, which has come into force w.e.f. 1st July, 2017 has been added and the assessee will have to mention GSTIN in this clause.

b. Clauses 19 & 24 – Allowance and deemed income under section 32AD

Under clause 19 details of various allowances admissible under provisions from section 32AC to 35E are required to be mentioned. To this list amount admissible under section 32AD has been added.

Section 32AD(1) provides an allowance of 15% of actual cost of new assets acquired and installed, on or after 1st April, 2015 but before 1st April, 2020, in any undertaking or enterprise set up after 1st April, 2015 for manufacture or production of any article or thing in any backward area of States of Andhra Pradesh, Bihar, Telangana and West Bengal. The section was introduced w.e.f. 1st April, 2016 and the details of amount debited to profit and loss account and amount admissible under the said section has to be mentioned.

The term "new asset" has been defined to mean any new plant or machinery (other than ship or aircraft) subject to certain exclusions mentioned in section 32AD(4).

Under clause 24, hitherto amounts deemed to be profits and gains under sections 32AC or 33AB or 33ABA or 33AC are to be reported. To this list section 32AD is added. As per provisions of sub-section (2) of section 32AD, if any asset, in respect of which deduction is claimed is sold within a period of five years from the date of its installation, then any deduction allowed under sub-section (1) of section 32AD is deemed to be income of the year in which such asset is transferred. There are certain exceptions made for reorganisation, amalgamation or demerger covered under clauses (xiii), (xiiib) or (xiv) section 47.

If the successor, covered under clauses (xiii), (xiiib) or (xiv) of section 47 to whom the said assets are transferred and availed benefit of sub-section (2) as mentioned above, sells the same within a period of five years from the date of installation it shall have to offer the amount of deduction claimed by the predecessor under section 32AD(1) and also report the same under clause 24.

c. Clause 26 – Deductions only on actual payment under section 43B

By Finance Act, 2016 clause (g) was inserted in section 43B w.e.f. 1st April, 2017. As per the said clause (g), any sum payable by an assessee to the Indian Railways for the use of railway assets is allowable as deduction only if the payment of the same is made before the due date of filing the return of income. The reference to said clause (g) is now being added to the clause 26 and same will need to be reported therein.

d. Clause 31 – Mode of undertaking transactions and repayment of loans or deposits

(i) By Finance Act, 2017 a new section 269ST was inserted to take effect from 1st April, 2017 prescribing mode of undertaking transactions. As per the provisions of the said section no person can receive a sum of two lakh rupees or more, in aggregate in a day or in respect of a single transaction or in respect of a transaction relating to one event or occasion from a person, otherwise than by an account

payee cheque or an account payee bank draft or use of electronic clearing system through a bank account.

Certain exceptions are carved out to the above in form of receipts by Government, banking companies, post office savings bank or co-operative banks and person or class of persons or receipts notified *vide* Notification No. S.O. 2065(E) dt. 3rd July, 2017.

Similarly, provisions of section 269ST shall not apply to receipt by any person from a banking company or post office savings account or co-operative bank [Notification No. S.O. 1057(E) dated 5th April, 2017.

Both the above Notifications were made effective from 1st April, 2017.

Section 269ST

(ii) A new sub-clause (ba) is inserted in clause 31 wherein particulars of **each receipt**, *otherwise than by a cheque or bank draft or use of electronic clearing system through bank account*, in an amount exceeding the limit specified in section 269ST are required to be reported.

Under this clause (1) Name, address and PAN (if available) of the payer; (2) Nature of Transaction; (3) Amount of Receipts in rupees and (4) Date of receipt need to be reported.

(iii) A new sub-clause (bb) is inserted in clause 31 wherein particulars of **each receipt,** *otherwise than by an* ***account payee*** *cheque or an* ***account payee*** *bank draft,* in an amount exceeding the limit specified in section 269ST are required to be reported.

Under this clause (1) Name, address and PAN (if available) of the payer and (2) Amount of receipt in rupees, need to be reported.

(iv) A new sub-clause (bc) is inserted in clause 31 wherein particulars of **each payment,** *otherwise than by a cheque or bank draft or use of electronic clearing system through bank account*, in an amount exceeding the limit specified in section 269ST are required to be reported.

Under this clause (1) Name, address and PAN (if available) of the payee; (2) Nature of Transaction; (3) Amount of Receipts in rupees and (4) Date of receipt need to be reported.

(v) A new sub-clause (bd) is inserted in clause 31 wherein particulars of **each payment**, *otherwise than by an* ***account payee*** *cheque or an* ***account payee*** *bank draft,* in an amount exceeding the limit specified in section 269ST are required to be reported.

Under this clause (1) Name, address and PAN (if available) of the payer and (2) Amount of receipt in rupees, need to be reported.

(vi) Receipt by or payment to the following are not required to be reported in sub-clauses (ba), (bb), (bc) or (bd) –

(1) Government Company; or

(2) Banking Company; or

(3) Post Office Savings account; or

(4) Co-operative Bank; or

(5) Transactions referred to in section 269SS; or

(6) Persons referred to in Notification No. S.O. 2065(E) dt. 3rd July, 2017.

(vii) While the section has put restrictions on receipts while undertaking a transaction, reporting in respect of payments is also sought.

(viii) The tax auditor will need to obtain the above details from the auditee and verify

the same with the records maintained in this respect. A detailed scrutiny of receipts and payments recorded in cash book and journal will also be necessary to verify transactions above two lakh rupees.

(ix) In respect of receipts or payments over the prescribed limit, difficulties could be faced in verifying whether same are by account payee cheque or account payee bank draft. In such a scenario necessary comments as suggested in para 49.6 of Guidance Note on Tax Audit under section 44AB of the Income-tax Act, 1961, Revised 2014 Edition (GN) should be included with necessary modifications.

(x) The tax auditor may also be faced with difficulties in determining whether a receipt or payment is in respect of transactions relating to one event or occasion. The tax auditor will have to use his professional judgment in determination of the same and also obtain necessary representation from the auditee wherever needed. *Vide* circular No. 22 of 2017 dt. 3rd July, 2017, in respect of receipt of instalments by NBFC it has been clarified that each instalment shall constitute a single transaction for the purpose of section 269ST(b) and all the instalments paid for a loan shall not be aggregated for determining applicability of provisions of section 269ST.

(xi) The tax auditor shall also need to satisfy that the reporting in respect of payments sub-clauses (bc) and (bd) is consistent with reporting under sub-clause (d) of clause 21 relating to expenditure covered under section 40A(3).

Section 269T

(xii) There were certain inconsistencies / anomalies in sub-clauses requiring reporting of details relating to repayment of loans or deposit. Same are sought to be removed by making changes in sub-clauses (c), (d) and (e) of clause 31.

e. Clause 34 – Details of TDS/TCS statements furnished

In sub-clause (b), where an assessee is required to furnish statement of TDS or TCS details of furnishing the same are required to be reported.

In last column of the table under the said sub-clause, it is required to state that –

"Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported".

The same is sought to be changed and expand the scope of reporting as under –

"Whether the statement of tax deducted or collected contains information about all transactions which are required to be reported. ***If not, please furnish list of details/transactions which are not reported".***

This requirement of furnishing the list of details/transactions not reported will cast added responsibility on the tax auditor as he will have to carry out extensive audit procedures to satisfy himself that the details/ transactions are duly reported by the auditee in statements of TDS/TCS furnished by the auditee.

B. Insertion of new clauses

a. Clause 29A – Forfeiture of an advance

(i) Under clause (ix) to section 56(2) any sum of money received as an advance or otherwise in the course of negotiation for transfer of a capital asset is taxable if such sum is forfeited and such negotiation do not result in transfer of such capital asset. The said clause was inserted w.e.f. 1st April, 2015 by Finance (No. 2) Act, 2014. Only advances relating to transfer of capital asset as defined under section 2(14) can be brought to tax under the said provision. This does not cover other business advances within its purview.

(ii) Details relating to nature of such income and amount thereof is required to be furnished in clause 29A.

(iii) The tax auditor will have to obtain details of all advances appearing as liability in the balance sheet of the assessee and determine from the details furnished by the auditee whether any of such advance is in connection with transfer of a capital asset. The tax auditor will have to obtain specific representation as to whether any such negotiation is terminated or not. In cases where minutes are maintained, the same will also need to be perused to see if any fact of negotiation relating to any such transaction for transfer of capital asset are terminated without fructification and the amount received as advance, if any, is forfeited. The tax auditor may also obtain confirmation of the third person in respect of amounts outstanding.

(iv) The auditee may take a view that such forfeiture of amount is not taxable based on certain judicial decision or expert legal opinion. In such an event appropriate disclosure of such fact should be made in the reporting under the said clause and attention should be drawn to the same in observation para in Form No. 3CA or 3CB.

b. Clause 29B – Deemed Gift

(i) Clause (x) was inserted in section 56(2) w.e.f. 1st April, 2017 by Finance Act, 2017. The said clause applies to every receipt by any person in the following event –

(1) Any sum of money without consideration, the aggregate value of which exceeds fifty thousand rupees; or

(2) Any immovable property without consideration of which stamp duty value exceeds fifty thousand rupees or where the difference between stamp duty value and consideration paid is more than fifty thousand rupees; or

(3) Any property without consideration the fair market value (FMV) of which exceeds fifty thousand rupees or where the difference between FMV and consideration paid is more than fifty thousand rupees.

(ii) There are certain exceptions provided in the said clause and the said deemed gifts are taxable in the year of receipt.

(iii) While determining the value taxable in respect of receipt of sum of money or immovable property there will not be much challenge. However, for determination of value of movable property the tax auditor will have to satisfy himself that same is in accordance with rules 11U and 11UA and in appropriate circumstances valuation reports are also obtained. It may be noted that the property mentioned in sub-clause (c) to section 56(2)(x) refers to only eight items being shares and securities, jewellery, archaeological collections, drawings, paintings, sculptures, any work of art and bullion.

(iv) The tax auditor will have to verify whether there are any additions of the type of assets mentioned (i) above during the year of audit and in the balance sheet.

(v) In cases where minutes book are required to be maintained, same may be perused to see if there are receipt of any gratuitous assets. In case of corporate entities the auditor should also examine various reserve accounts to see whether any assets are passing through such an account.

(vi) In case of partnership firm or proprietary concerns the auditor should also verify

the capital or other accounts of the partners or proprietor, in the books of the auditee, as the case may be.

(vii) In respect of the immovable property the auditor will have to obtain and verify the registered document with the price recorded in the books of account. In case the agreement is not registered the tax auditor may insist on obtaining such value certified by an expert and in such an event procedure prescribed under SA 620 relating to opinion of an auditors expert may be followed. In case the auditee does not agree to obtain opinion of an auditors' expert or is of the view that such an opinion is not necessary, such fact may be disclosed along with auditee's view, if any.

(viii) In respect of the other property the tax auditor must satisfy himself of the value recorded in the books of account with the FMV of such property determined in accordance with Rules 11U and 11UA. Appropriate representation should be obtained wherever necessary in respect of the determination of the FMV of an asset.

(ix) If an auditee is of the view that such receipts are not taxable based on certain judicial pronouncements or some expert legal opinion, the tax auditor shall make adequate disclosure of such fact, alongwith auditee's view, in the reporting of the clause as his comment and in observation clause in Form No. 3CA or 3CB, as the case may.

(x) In any case, in case of audit of books of account of proprietary concerns, it would be advisable for the tax auditor to disclose that the reporting in the said clause is verified only on the basis of information supplied by the auditee and from books of account that are subject to audit.

c. Clause 30A – Transfer Pricing – Secondary Adjustment

(i) Section 92CE is introduced in transfer pricing provisions by Finance Act, 2017 w.e.f. 1st April, 2017. As per the provisions of the said section an assessee is required to make secondary adjustments in respect of transaction where primary adjustment is made, in respect of an assessment year commencing after 1st day of April, 2016, of an amount exceeding one crore rupees is made in following circumstances –

(1) By the assessee himself in his return of income; or

(2) By the assessing officer which have been accepted by the assessee; or

(3) By determination in Advance Pricing Agreement under section 92CC; or

(4) As per safe harbour rules framed under section 92CB; or

(5) By result of resolution of an assessment under mutual agreement procedure (MAP).

(ii) Secondary adjustment is defined to mean adjustment in books of account of the assessee and its associated enterprise to reflect the actual allocation of profits between the assessee and its associated enterprise are consistent with the transfer price determined as a result of primary adjustment, thereby removing the imbalance between cash account and actual profit of the assessee.

(iii) As per section 92CD(2), the excess money, which is available with the associated enterprises as a result of primary adjustment, is required to be repatriated to India within prescribed time, failing which same shall be treated as advance made by the auditee to its associated enterprise and interest on such advance

shall be computed in prescribed manner (see rule 10CB).

(iv) As per clause 30A, newly inserted, an auditee will have to furnish following details where primary adjustment to transfer price, as discussed above, is made during the previous year –

- Clause of section 92CE(1) under which primary adjustment is made;
- Amount of primary adjustment;
- Whether the excess money available with the associated enterprise is required to be repatriated to India?
- If yes, whether same is repatriated to India within prescribed time?
- In not repatriated, then amount of imputed interest on amounts not repatriated within prescribed time.

(v) The tax auditor will have to obtain details of happening of any of the events described in (i) above during the previous year. It may be noted that only situations described in section 92CE during the previous year are required to be reported. From the details obtained the tax auditor will need to satisfy that all the conditions relating to recognition of the difference between arm's length price determined in primary adjustment and price at which international transaction has actually taken place is duly recognised in the books of account. The tax auditor will have to satisfy himself of fulfilment of the conditions laid down in section 92CE and obtain necessary documentation in respect of the same.

(vi) It would have been more appropriate to include this reporting along with reporting in Form No. 3CEB relating to transfer pricing rather than including the same in Form No. 3CD as it is of relevance in case covered by the transfer pricing provisions.

d. Clause 30B – Limitation on interest deduction under section 94B(1) in certain cases

(i) Section 94B was inserted w.e.f. 1st April, 2018 by the Finance Act, 2017. As per the provisions of the said section there is restriction on deductibility of excess interest expenditure incurred, by an Indian company or a permanent establishment of a foreign enterprise, over one crore rupees in respect of any debt issued by a non-resident being associated enterprise of the borrower, in computing income under the head profits and gains from business or profession. As per section 94B(2) excess interest means an amount of total interest paid or payable in excess of thirty per cent of earnings before interest, taxes, depreciation and amortisation (EBITDA) of the borrower in the previous year or interest paid or payable whichever is less. The provisions are not applicable to an Indian company or PE of a foreign company if it is engaged in the business of banking or insurance.

Where an associated enterprise provides an implicit or explicit guarantee to a lender or deposits a corresponding and matching amount of funds with the lender, such debt shall also be deemed to have been issued by an associated enterprise for the purpose of section 94B.

(ii) The amount of excess interest incurred, in respect of which deduction is not available, can be carried forward under section 94B(4) for eight assessment years and can be deducted to the extent of maximum allowable interest expenditure as computed under section 94B(2) in any of the eight succeeding assessment years.

(iii) Under clause 30B an auditee will have to furnish the following details –

- Whether interest expenditure covered under section 94B(1) is incurred?

- Amount of expenditure by way of interest or of similar nature incurred;
- EBITDA during the previous year;
- Interest in excess of EBITDA;
- Interest expenditure of earlier year brought forward under section 94B;
- Interest expenditure carried forward as per provisions of section 94B(4).

(iv) Most of these enterprises paying interest to associated enterprises and the nature of transactions covered within section 94B are also subject to transfer pricing provisions. It would have been in order to have included this reporting in Form No. 3CEB instead of Form No. 3CD and burdening all the assessees with this reporting requirement.

(v) The tax auditor will have to obtain the details of borrowings by an auditee from its non-resident associated enterprises. He will also need to refer to Form No. 3CEB for the transactions of borrowings and guarantees reported in the said report. If the borrowing has been in the years preceding the previous year then details of all such transaction will have to be obtained from the auditee.

(vi) The tax auditor will also need to obtain details of borrowing from others which are backed by the security of non-resident associated enterprise. In the direct confirmation to be obtained from banks and others the auditor should verify the nature of security where any of the borrowings are stated to be secured.

(vii) The auditor should also satisfy himself with the disclosures relating to transactions with related parties made in the notes to accounts. He should also ensure that the reporting is consistent with reporting under clause 40A(2)(b) in clause 23 of Form No. 3CD.

e. Clause 30C – GAAR

(i) The provisions of General Anti Avoidance Rule (GAAR) are contained in Chapter X-A. The said provisions provide the circumstances in which an arrangement entered into by an assessee may be declared as impermissible avoidance agreement and consequences that follow from such a declaration of an arrangement as impermissible avoidance arrangement. There are provisions which provide for circumstance in which situation of impermissible avoidance arrangement arise, arrangement lacking commercial substance, treatment, consequential treatment, guidelines for application of the provisions. The guidelines are contained in Rules 10U to 10UC. According to the said guidelines the provisions of GAAR do not apply to an arrangement if the tax benefit in the relevant assessment year, in aggregate, to all the parties to the arrangement does not exceed three crore rupees. There are other exclusions also to the GAAR. Before any consequential treatment is meted to a given arrangement it has to be declared as impermissible avoidance arrangement by an Approving Panel under section 144BA(6) and the said section 144BA contains elaborate procedure for such a declaration being made.

(ii) Briefly stated the procedure for declaring an arrangement to be an impermissible avoidance arrangement requires following procedure to be adopted –

(1) Determination by the assessing officer for an arrangement to be declared as impermissible.

(2) Seeking objections of the assessee before making a reference to the Commissioner;

(3) On disposal of objection reference to Commissioner setting forth all the relevant details;

(4) The Commissioner on receiving a reference to consider objections of the assessee to the proposed action under section 144BA(4) and if satisfied making reference to approving panel;

(5) The Approving Panel can after investigating the matter as provided in section 144BA(8) can issue direction for an arrangement to be declared as impermissible avoidance arrangement.

(iii) Thus, an elaborate procedure is prescribed before an arrangement is declared as impermissible avoidance arrangement requiring three levels of enquiry and adherence to the principles of natural justice, hearing the assessee, determining the consequences and amounts involved. Thus, a very high degree of investigation is involved in the whole process.

(iv) Now *vide* the new clause 30C inserted in Form No. 3CD following details are required to be furnished –

- Whether assessee has entered in to an impermissible avoidance arrangement, as referred to in section 96?
- Nature of impermissible avoidance arrangement;
- Amount of tax benefit in the previous year arising, in aggregate, to all the parties to the arrangement.

(v) As per section 96, an impermissible avoidance arrangement is one whose main purpose is to obtain a tax benefit and satisfies following conditions –

- Creates rights, or obligations, which are not ordinarily created between persons dealing at arm's length;
- Results, directly or indirectly, in the misuse, or abuse, of the provisions of the Act;
- Lacks commercial substance or is deemed to lack commercial substance under section 97, in whole or in part; or
- Is entered into, or carried out, by means, or in a manner, which are not ordinarily employed for *bona fide* purposes.

(vi) Section 97 specifies what is meant by lack of commercial substance elaborately.

(vii) This reporting casts onerous responsibility on the auditor which all the professional bodies need to oppose. As seen earlier, this requirement is beyond the scope and objective of the section 44AB as further clarified in para 17.2 of the Circular No. 387, dated 6th July, 1984 [(1985) 152 ITR St. 11]. The very fact that section 144BA lays down an elaborate process requiring three stages of filtering before an arrangement can be declared as an impermissible avoidance arrangement, it is clearly beyond the scope of the tax auditor. It further needs to be noted that the primary responsibility is that of an assessee to furnish the particulars in Form No. 3CD. The duty of the tax auditor is confined to verification of the said particulars and report on truth and correctness of the same. The matters listed in section 96 not only require elaborate investigation entrusted upon the assessing officer, commissioner and the approving panel but also are highly subjective matters. Unlike matters which are objective on which opinion as to truth and correctness can be given, a similar opinion on

subjective matters cannot be given by the tax auditor.

(viii) In an appropriate case the tax auditor would also be entitled to disclaim any expression of opinion in respect of this clause.

f. Clause 36A – Deemed Dividend

(i) Under clause (e) of section 2(22) certain advance or loan given by a company, in which public are not substantially interested, to a person who is the beneficial owner of shares, as defined in the said section, or to any concern in which such shareholder is beneficially interested or for the individual benefit of any such shareholder, then such advance or loan is deemed to be dividend to the extent of accumulated profits.

(ii) A new clause 36A is inserted in Form No. 3CD requiring furnishing of the following details –

- Whether the assessee has received any amount in the nature of dividend as referred in sub-clause (e) of clause (22) of section 2?
- Amount received;
- Date of receipt.

(iii) The tax auditor will be required to exercise due care in respect of such transactions and devise elaborate checklist to carry out the audit process. The tax auditor should obtain the list of all the entities in which the auditee is a beneficial owner and all the transactions carried out with such entities. It may be noted that this needs to be reported if the auditee itself is a registered as well as beneficial owner. There are conflicting judgments on the issue and if the assessee places reliance on any favourable judgment the said fact should be brought out in the report.

(iv) The auditor should verify the list with reporting made under clause 23 and notes to accounts in respect of transactions with related parties to satisfy himself about the veracity of the list of such entities provided by the auditee.

(v) It may be noted that *bona fide* business transactions may not always be covered by the fiction of section 2(22)(e) and the tax auditor will have exercise professional judgment in deciding whether the transactions are *bona fide*. In case of difference of opinion with the auditee the view of the auditee as well as the tax auditor should be furnished in the report.

g. Clause 42 – Furnishing of statement in Form Nos. 61 or 61A or 61B

(i) Under section 139A(5) every person entering into certain specified transactions is required to quote his PAN. As per second proviso to Rule 114B a person who does not have a PAN is required to furnish a declaration in Form No. 60. The entities or persons receiving such declarations in Form No. 60 are required to report the same in Form No. 61 by 31st October for declarations received up to 30th September and 30th April for declarations received up to 31st March.

(ii) The statement of financial transactions is required to be furnished under section 285BA(1) in Form 61A for certain specified transactions by a reporting person mentioned therein under Rule 114E for financial year by 31st May.

(iii) The statement of reportable account is required to be furnished under section 285BA(1)(k) by reporting financial institutions for each reportable account which has been identified pursuant to due diligence procedure specified in Rule 114H for every calendar year by 31st May.

(iv) A new clause 42 has been inserted in Form No. 3CD asking for the following details –

- Whether auditee is required to furnish all or any of the above statements;
- Following details in table form –
  - Reporting Entity identification number;
  - Type of Form;
  - Due date of furnishing;
  - Date of furnishing, if furnished;
  - Whether form contains information about all details/ transactions which are required to be reported. If not, list of details/transaction not reported to be furnished.

(v) The tax auditor shall have to obtain the details of all such statements furnished during the previous year. An elaborate checking of the transactions required to be so reported will have to carried-out by the tax auditor and audit plan will have to be duly modified to cover this exercise.

h. Clause 43 – Furnishing of report in respect of International Group

(i) Section 286 was inserted by Finance Act, 2016 w.e.f. 1st April, 2017 whereby every constituent entity resident in India, if it is constituent of an international group, the parent entity of which is not resident in India (alternate reporting entity) or a parent entity resident in India, is required to furnish a report for every reporting accounting year, in respect international group of entity of which it is a constituent, to the prescribed authority within a period of twelve months from the end of the reporting accounting year, in a prescribed form in prescribed manner.

(ii) In the new clause 43 inserted following details are required to be furnished –

- Whether report has been furnished by the assessee or its parent entity or an alternate reporting entity;
- Name of the parent entity;
- Name of alternate reporting entity (if applicable);
- Date of furnishing report.

(iii) The tax auditor should ascertain from the auditee whether such report was furnished by the entity or its parent or it's alternate reporting entity. The tax auditor is not required to study the information in detail however he should take note of the same to the extent relevant.

(iv) The details will be required to be furnished in respect of the reports that are due and furnished during the previous year.

i. Clause 44 – Break-up of Total Expenditure

(i) Putting cart before the horse, this is what one can say about reporting under this clause. Even before the audit report for GST can be notified the details are being asked by the Income-tax department. Virtually, complete reconciliation of GST compliance of the whole of debit side of profit and loss account will have to be done by every auditee whether registered or not for GST.

(ii) The following details are required to be furnished in the table form –

- Total amount of expenditure incurred during the year;

- Expenditure in respect of entities registered under GST, with further breakup of –
  - Relating to goods or services exempt from GST
  - Relating to entities falling under the composition scheme
  - Relating to other registered entities
  - Total payment to registered entities
- Expenditure relating to entities not registered under GST

(iii) It is not clear from the clause whether reporting has to be done of revenue expenditure only or also for the capital expenditure?

(iv) This reporting is a bit premature as the GST audit report is not yet notified and also the systems of all the entities will not be calibrated to meet this reporting requirement.

(v) In any case every entity wide details will be available in GSTIN and can be shared amongst both the department. Asking for this type of information is classic case of multiple reporting which does not serve any meaningful purpose.

Conclusion

- It is really intriguing that despite the Delhi High Court, in *Avinash Gupta vs. UOI (2015) 378 ITR 137,* having directed the CBDT that the forms which are to be prescribed for the audit reports and filing of the income-tax returns should be made available to the assessee as on 1st April of the assessment year, unless there is a valid reason for the issue of the same and for the delay reasons should be recorded in writing. This ultimately leads to stakeholders demanding extension of time leading to delays in filing. This serves no purpose at all. If one were to see none of the clauses amended or inserted are result of any provisions that have been introduced after Finance Act, 2018. Also, there would have been no loss to the Revenue if these were postponed by one year as in any case many of the details are already captured through other filings.
- More intriguing is the fact that in clauses 29A, 29B, 30C and 36A the matters to be reported require investigational powers and lot of subjectivity is involved. These are beyond the scope of the mandate of section 44AB as explained in circular number 387 (*supra*). The introduction of clause 44 without the GST audit report being finalised and notified by the CBIC. Out of the nine new clauses inserted six shall not be applicable to ninety five per cent of the cases. Thus, it is most essential that the CBDT changes the date of implementation of the circular to next year and withdraws the four clauses which require investigational powers to be used before deciding the matter as they are beyond the scope of tax audit. The withdrawal of the circular will not affect the collection of tax, will lead to timely completion of audit and break the cycle of seeking extensions.
- Hope the wiser counsel prevails!

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V. Sridharan, *Advocate*, Amar Gahlot, *Ex-IRS* & Akhilesh Kangsia, *Advocate*

Benefit of Doubt goes to Whom?

1. A long-standing position pertaining to interpretation of an exemption notification in favour of assessee in case of doubt / ambiguity, has now been revisited by the Constitutional Bench of the Hon'ble Supreme Court in the case of *Dilip Kumar and Co., reported at 2018-VIL-230-SC-CU-CB.* This article endeavours to analyse the legal principles involved in the interpretation of tax exemptions, in the context of this recent decision of the Apex Court.

2. The above matter came up before the Constitutional Bench of the Apex Court on reference by its Division Bench in the case of *Dilip Kumar and Co.*, wherein a doubt arose regarding the correctness of an earlier judgment of the Court in *Sun Exports case reported at 1997 (6) SCC 564.* The Division Bench in *Dilip Kumar and Co.*, case was addressing the issue as to whether 'Vitamin-E50 powder' a prawn feed supplement is covered by notification extending exemption to 'prawn feed' or not. Though this Court extended the above exemption to goods imported, however, the Division Bench referred the matter to Constitutional Bench to decide correctness of judgment in *Sun Exports* wherein it was held that *'in case of two views possible, it is well-settled, that one favourable to the assessee in matters of taxation has to be preferred'.*

3. The Constitutional Bench answered the reference in the following matter:

   a. Exemption notifications should be interpreted strictly; the burden of applicability would be on the assessee to show that his case comes within the parameters of the exemption clause or exemption notification,

   b. When there is ambiguity in exemption notification which is subject to strict interpretation, the benefit of such ambiguity cannot be claimed by the subject / assessee and it must be interpreted in favour of the revenue.

   c. The ratio of *Sun Exports case* is not correct and all the decisions which took similar view as in the *Sun Exports case* stands over-ruled.

4. Do the above *ratio decidendi* bring about any change in settled law around the above issues, is the moot question.

5. For the first issue, it would be prudent to refer to the authoritative text *'Principles of Statutory Interpretation'*, by Justice G. P. Singh, 11th Ed., wherein the author explains in Chapter 10 'Construction of Taxing Statutes and Evasions, at pages 794-795, the jurisprudence for applicability of the principle of strict interpretation to exemption notification. He explains that exemptions which lift the restrictions of taxability imposed by an Act are taxing in nature and are therefore subject to the rule of strict construction.

6. Thus, taxability is a rule and exemptions are an exception to this rule. From an economic rationale, it is obvious that when any exemption from the charge of tax is granted to a class of taxpayers, it leads to the shifting of burden to other taxpayers. The intention or purpose behind such exemption thus assumes much importance in the interpretation of such provisions. Therefore, when such exemption is construed liberally, beyond the intention for which it was introduced, there is an unequitable and unintentional shift in the burden to the other taxpayers. Hence strict interpretation of an exemption is a necessity.

7. Thus what has been concluded by the Apex Court, is just a reiteration of the well-settled position in law that (a) strict rule of interpretation is mandatory for interpretation of a charging section of a taxation statue and if there are two views possible, the one favourable to assessee needs to be applied (refer to judgment of Apex Court in *Vegetables Products reported at 1973 (88) ITR 192)*, and (b) in case of exemptions from the charge of tax also, strict rule of interpretation is mandatory, however, if two views possible, then the view favourable to revenue should be applied. Refer to judgment of Apex Court in *Novopan India Ltd. reported at 1994 Supp (3) SC 606 and in Wood Papers Ltd. reported at (1990) 4 SCC 256 (Para 4, Pg. 260).*

8. To complete the discussion, however, it would be relevant to state here that interpretation of an exemption notification might require a combination of strict as well as liberal interpretation, depending on the stage of applicability which is being interpreted. For instance, firstly, at the stage when the taxpayer's eligibility under an exemption notification is being assessed, strict interpretation is the rule to be followed. Secondly, once the taxpayer fulfils the eligibility criteria and falls within the ambit of the notification, a wider and liberal construction is to be followed. The jurisprudential basis for the above is explained in *Novopan supra* and in *Wood Papers Ltd. supra*. The Constitution Bench has consciously discussed this issue as well and has followed the same.

9. The judgment in *Sun Exports* supra was the basis for reference of the Dilip & Co case to the Constitution Bench. In 1997, *Sun Exports,* the Apex Court had held that while interpreting an exemption notification, if two views are possible, 'it is well settled' that one favourable to the assessee is to be preferred. However, the Court in that case did not elaborately deal with this conclusion, and did not refer to any decisions which it was relying on.

10. The Constitutional Bench has overruled *Sun Exports* reiterating the settled law that unlike taxing statute, if two views are possible while interpreting exemption notice, one favourable to the revenue should be applied. Refer the judgment in Novopan India *supra.*

11. *Dilip Kumar & Co.,* thus does not bring about any change in law on this issue.

12. Here, the authors wish to submit that there are certain aspects that have not been

discussed in detail by the Constitutional Bench related to exemptions which are in nature of incentive given with a beneficent objective in mind, e.g., to encourage manufacture and exports, industrial development, etc. Such exemptions should be interpreted differently, and in a liberal manner, since the purpose / intention behind such exemptions is not to exempt from the levy of tax on any legal basis, but to incentivise the subject/assessee as a policy measure. This aspect has been considered in detail by the Hon'ble Supreme Court in *Bajaj Tempo reported at 1992 AIR 1622* and *CC vs. Rupa & Co. Ltd., reported at 2004 (6) SCC 408.* Further, there are notifications though called exemptions, but sometimes, levy is also by the very notification for e.g., notification issued under Section 9A of the Customs Tariff Act, 1975 for levy of anti-dumping duty. In such instances, the principle of strict interpretation has to be applied and what is to be looked at is the notification and nothing beyond it. This aspect is also not considered by the Constitutional Bench.

13. A jurisprudential question arises here – what does the Court mean when it says that two views are possible in a given fact situation? Cleary, the role of the Court is to interpret laws, and interpretation is required only where there are multiple conflicting views possible. The role of the Courts here is to identify the *sententia legis*, i.e. the intention of the Legislature – such intention could be one and only one. Thus, in a particular fact situation, is it that the possibility of two reasonable views suggests the failure of the Court to interpret the law using the fundamental rules of interpretation? In *Dilip Kumar & Co.*, the authors are of the view that the Court has straightaway laid down a bright-line test which is favouring the revenue, without considering different rules of interpretations. Given the complexity of taxing statutes and varied exemption provisions, clearly a universal test cannot be laid down.

14. The authors fear that such decisions may lead to an aggressive approach by the revenue for denial of exemption (including exemption which are in nature of incentives), due to lack of clarity, and every availment of exemption by assessee would lead to unnecessary litigation and penal action though the Court has always held that claiming the benefit of exemption notification does not amount to mis-declaration [refer the decision in *Northern Plastics reported at 1998 (101) ELT 549 (SC)].*

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When the world is the end and God the means to attain that end, that is material.When God is the end and the world is only the means to attain that end, spirituality has begun.

— Swami Vivekananda

B. V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

Secion 158BB Block Assessment: In order to add any income in the block assessment, evidence of such income must be found in the course of the search u/s. 132, any material or evidence found/collected in a survey u/s. 133A which has been simultaneously made at the premises of a connected person can also be utilised while making the Block Assessment. The same would fall under the words "and such other materials or information as are available with the Assessing Officer and relatable to such evidence" occurring in Section 158 BB

CIT vs. S. Ajit Kumar Civil Appeal No. 10164 of 2010 dated 2nd May, 2018

1. The facts in this are that search operation was conducted on the premises of the assessee on 17-7-2002 which was concluded on 21-8-2002. On the same day, there was a survey in the premises of Elephant Constructions and Interiors Ltd. ('ECIL') – the builders and interior decorators who constructed and decorated the house of the assessee. At the time of survey in the builder's premises, the fact that the assessee having paid amount of ₹ 95,16,000/- to ECIL in cash was revealed which was not accounted for.

2. The Assessing Officer completed the block assessment and in the assessment order, *inter alia,* held that the said amount is liable to tax as undisclosed income of the block period.

On appeal, the CIT(A) held that it was due to the search action that the Department had found that the assessee had engaged the services of M/s. ECIL. Hence, the order of block assessment was upheld.

On further appeal, the Tribunal set aside the decisions of the A.O. and learned CIT(A) and allowed the appeal of the assessee.

Being aggrieved, the Revenue filed an appeal before the High Court which was dismissed.

Consequently, the Revenue was before the Supreme Court in the instant appeal.

3. The short point for consideration was that whether in the light of the facts in the case, the material found in the course of survey in the premises of the builder could be used in Block Assessment of the assessee?

4. The case of the Revenue was that the High Court failed to consider that the information gathered as a result of search was not the details of appointment of interior decorator rather it was information regarding the cash payments made over and above the cheque payments and not accounted by the assessee. It was also contended that it was the standard practice in the Department that when a search took place in the case of an assessee, many related business premises were simultaneously covered under survey and were part of the search process. In this regard the reliance was placed on the decision of the Apex Court in the case of *ACIT vs. Hotel Blue Moon (2010) 3 SCC 259.* The assessee on the other hand placed reliance on various decisions of the Supreme Court and various High Courts and contended that the fact of cash payment found in survey conducted at the premises of M/s. ECIL did not fall within the ambit of block assessment.

5. Allowing the appeal of the Revenue the Supreme Court held as under:

"9) It is a cardinal principle of law that in order to add any income in the block assessment, evidence of such must be found in the course of the search under Section 132 of the IT Act or in any proceedings simultaneously conducted in the premises of the assessee, relatives and/or persons who are connected with the assessee and are having transaction/ dealings with such assessee. In the present case, the moot question is whether the fact of cash payment of ₹ 95.16 lakhs can be added under the head of the undisclosed income of the assessee in block assessment."

6. The Supreme Court considered that in the instant case, cost of investment was disclosed by the assessee in the return filed and details of transactions with ECIL were also disclosed however, the assessee had not disclosed payment of ₹ 95,16,000 made in cash to ECIL. After considering the provisions of the sections 158BB and 158BH the Supreme Court held as under:

"13) On a perusal of the above provision, it is evident that for the purpose of calculating the undisclosed income of the block period, it can be calculated only on the basis of evidence found as a result of search or requisition of books of account or other documents and such other materials or information as are available with the Assessing Officer and relatable to such evidence. Section 158BB has prescribed the boundary which has to be followed. No departure from this provision is allowed otherwise it may cause prejudice to the assessee. Needless to say that it is the cannon of tax law that it should be interpreted strictly."

7. The Supreme Court further held that Section 158BH of the Act had made all other provisions of the Act applicable to assessments made under Chapter XIVB except otherwise provided under Chapter XIVB. Chapter XIV B of the Act, which relates to block assessment, had come up for consideration before the Supreme Court in the case of Hotel Blue Moon [(2010) 3 SCC 259] where it was held that Chapter XIV-B provides for an assessment of the undisclosed income unearthed as a result of search without affecting the regular assessment made or to be made. The said decision further held that Section 158-BH provided for application of the other provisions of the Act and the same was an enabling provision, which made all the provisions of the Act, save as otherwise provided, applicable for proceedings for block assessment. Considering the said decision it was held:

"15) The power of survey has been provided under Section 133A of the IT Act. Therefore, any material or evidence found/collected in a survey which has been simultaneously made at the premises of a connected person can be utilised while making the Block Assessment in respect of an assessee under Section 158BB read with Section 158 BH of the IT Act. The same would fall under the words "and such other materials or information as are available with the Assessing Officer and relatable to such evidence" occurring in Section 158 BB of the Act. In the present case, the Assessing Officer was justified in

taking the adverse material collected or found during the survey or any other method while making the block assessment."

8. As a result, all the appeals of the Revenue were allowed and decided against the assessee.

Only the income that has actually accrued to the assessee is taxable. What income has really occurred to be decided, not by reference to physical receipt of income, but by the receipt of income in reality. Even if there is no written agreement to the effect, the fact that the assessee was acting as a broker is relevant. The relationship of the assessee *vis-a-vis* others can be inferred from the conduct of the parties and agreement to this effect can be oral

DCIT vs. T. Jaychandran Civil Appeal No. 4341 of 2018 dated 24th April, 2018

1. In this case, the assessee was an individual and the proprietor of M/s. Chandrakala & Company, a stock broker registered with the Madras Stock Exchange. He was also an approved broker of the Indian Bank and acted for the said Indian Bank as a broker in purchase of the securities from different financial institutions.

2. It was case of the Revenue that in order to save itself from being charged unusually high rate of interest on borrowing money from the market, the Indian Bank lured PSUs to make fixed term deposits with it on high rate of interest. The rate of interest offered to the PSUs for making huge term deposits was to the extent of 12.75% against the rate of 8% approved in accordance with the RBI directions. In order to pay high rate of interest to the PSUs, the Indian Bank requested the assessee to purchase securities on its behalf at a prescribed price which was unusually high but adequate to cover the market price of the securities, brokerage/incidental charges to be levied by the assesse, apart from covering the extra interest payable to the PSUs. The assesse followed the instructions and carried out the purchase and sale transactions of securities, for which he was paid the commission by the Indian Bank.

3. The assessee filed his return of income. The case was selected for scrutiny and the assessment was completed by AO by adding the amounts realised by the sale of securities to be income of the assessee by holding that the assesse had not acted as a broker and rather had acted as an independent dealer and that there was no overriding title in favour of the PSUs with regard to additional amount earned out of securities transactions and hence, payment to the PSUs was an application of income after accrual in the hands of the assessee and the said amount was liable to be assessed as income of the assessee.

4. On appeal, the CIT(A) set aside the demand for additional tax while deciding the issue in favour of the assessee by holding that additional interest payable to the PSUs could not be considered as income of the assessee.

5. On further appeal by the Revenue, the Tribunal held the decision in favour of the Revenue by holding that there no overriding title existed in favour of the PSUs so as to cause diversion of income.

6. In the meanwhile, criminal proceedings were initiated against the assessee for the undertaking the transactions in question by the CBI Court. The said Court held the decision in favour of the assessee by holding that assessee acted in the capacity as a broker and not as an independent dealer. However, the Tribunal refused to rely on the evidence produced in the Trial Court and held that assessment proceedings were different from criminal proceedings and the evidence in Trial Court couldn't be relied upon to absolve the assessee from the tax liability.

7. Further appeal was filed before the High Court, who held the decision in favour of the assessee by setting aside the order of the Tribunal while relying on the evidence given in the Trial Court.

8. Aggrieved Revenue was before the Supreme Court, who held as under:

"10) The answer to the short question whether the alleged interest payable to the PSUs can be assessed as an income of the Respondent depends on the determination of true nature of relationship between the Indian Bank and the Respondent with regard to the transactions in question and the capacity in which he held the amount of ₹ 14,73,91,000/-. Now, coming to the question of relationship between the Indian Bank and the Respondent, the normal settlement process in Government securities is that during transaction banks make payments and deliver the securities directly to each other. The broker's only function is to bring the buyer and seller together and help them to negotiate the terms for which he earns a commission from both the parties. He does not handle either cash or securities. In this respect, the broker functions like the broker in the inter bank foreign exchange market. The conduct of the Respondent in the transaction in question cannot be termed to be strictly within the normal course of business and the irregularities can be noticed from the manner in which the whole transactions were conducted. However, the same cannot be basis for holding the Respondent liable for tax with regard to the sum in question and what is required to be seen is whether there accrued any real income to the Respondent or not."

"11) It is required to be seen in what capacity the Respondent held the said amount-independently or on behalf of the Indian Bank. The Assessing Officer, while passing order dated 25-1-1996, has held that there exists no agreement between the Respondent and the Indian Bank about the payment of additional interest to the PSUs and there was no overriding title in respect of the additional interest for the PSUs. However, the position in this regard is very much settled that an agreement need not be in writing but can be oral also and the same can be inferred from the conduct of the parties."

"12) Further, while considering the claim of the Respondent and the view of the Assessing Officer, how the bank itself had treated the Respondent, is a matter of relevance. At the outset, learned counsel appearing on behalf of the Revenue contended that the proceedings under the Income-tax Act are independent proceedings and the High Court committed a grave error in relying on the findings of the Criminal Court.We do not find any force in the contention of the appellant herein as the High Court has not held that the findings of the Criminal Court are binding on the Revenue authorities. Rather the High Court was of the view that the findings arrived at by the Criminal Court can be taken into consideration while deciding the question as to the relationship between the parties to the case. When the findings are arrived by a Criminal Court on the evidence and the material placed on record then in absence of anything shown to the contrary, there seems to be no reason as to why these duly proved evidence should not be relied upon by the Court. The High Court has specifically appraised the findings given by the CBI Court in this regard. The relationship between the Indian Bank and the Respondent is very much clear by the evidence led during the criminal proceedings.The Executive Director of the Bank has specifically spoken about the role of the Respondent as a broker specifically engaged by the Bank for the purchase of securities and that the Bank has included the interest money too in the consideration paid, for the purpose of taking demand drafts in favour of PSUs. Further, the evidence led by other bank officials points out that the price of securities itself were fixed by the bank authorities and as per their directions the Respondent had purchased the securities at the market price and the differential amount was directed to be used for taking demand drafts from the bank itself for paying additional interest to the PSUs. Further, the letter dated 25-3-1994 by the Bank wherein the Bank had acknowledged the receipt of Demand Drafts taken by the Respondent gives an unblurred picture about the capacity of the Respondent in holding the amount in question. Consequently, the conduct of the parties, as is recorded in the criminal proceedings showing the receipt of amount by the broker, the purpose of

receipt and the demand drafts taken by the broker at the instance of the bank are sufficient to prove the fact that the Respondent acted as a broker to the Bank and, hence, the additional interest payable to the PSUs could not be held to be his property or income."

"13) The income that has actually accrued to the Respondent is taxable. What income has really occurred to be decided, not by reference to physical receipt of income, but by the receipt of income in reality. Given the fact that the Respondent had acted only as a broker and could not claim any ownership on the sum of ₹ 14,73,91,000/- and that the receipt of money was only for the purpose of taking demand drafts for the payment of the differential interest payable by Indian Bank and that the Respondent had actually handed over the said money to the Bank itself, we have no hesitation in holding that the Respondent held the said amount in trust to be paid to the public sector units on behalf of the Indian Bank based on prior understanding reached with the bank at the time of sale of securities and, hence, the said sum of ₹ 14,73,91,000/- cannot be termed as the income of the Respondent. In view of the above discussion, the decision rendered by the High Court requires no interference."

Section 158BD: Although Section 158BD does not speak of 'recording of reasons' as postulated in Section 148, but since proceedings u/s. 158BD may have monetary implications, such satisfaction must reveal mental and dispassionate thought process of the AO in arriving at a conclusion and must contain reasons which should be the basis of initiating the proceedings u/s 158BD. Notice u/s. 158BC issued on the same date to the searched person and the other person is not valid as no reasonable or prudent man can come to the satisfaction of any undisclosed income without verification of material

Tapankumar Dutta vs. CIT Civil Appeal No. 2014 of 2007 dated 24th April, 2018.

1. The facts in this case were that the assessee was a partner in a partnership firm by name 'Nitya Kali Rice Mill' ('the Firm'). A search was conducted on the business premises of the firm by the Income-tax department on 6th November, 1998 and several documents/ books including sum of ₹ 34 lakh were seized. Thereafter a notice dated 9th September, 1999 was issued to the assessee (partner of the firm) by the AO u/s. 158BC to file returns of his total income including undisclosed income in respect of which he was assessable for the block period (1989-90 to 1999-2000). In pursuant to the same the assessee (partner) filed his block return on 8th November, 1999 declaring undisclosed income of ₹ 14 lakh. On the very same day, i.e., on 9th September, 1999, a separate notice u/s. 158BC was sent in the name of the firm by the very same AO. On 20th November, 2000, the block assessment order was passed by the DCIT accepting the return filed by the firm at ₹ NIL.

A fresh notice u/s. 158BC r.w.s. 158BD was issued on 20th November, 2000 to the assessee (partner) to file the block return. The assessee informed the AO that block return has already been filed for the said period on 8th November, 1999.

The AO passed the order assessing the undisclosed income at ₹ 3,48,56,430/- which was challenged in appeal. The CIT(A) held that undisclosed income should be taken at ₹ 66,55,911/-.

Being aggrieved, both the parties preferred appeals before the Tribunal and the Tribunal dismissed the appeal of the assessee while partly allowed the appeal of the Revenue.

The assessee carried the matter before the High Court which was dismissed.

Being aggrieved, the assessee was before the Supreme Court.

2. The only point for consideration before the Supreme Court was whether in the facts and circumstances of the case, the issue of Second (Fresh) Notice under Section 158BD of the Act was valid or not.

3. The case of the assessee was that the first notice issued u/s. 158BC dated 9-9-1999 was the valid notice and the assessment ought to have been made in pursuance thereof and the AO had no authority to issue the second notice u/s.158BD. It was further contended that the firm as well as the assessee were assessed by the same Assessing Officer wherein Section 158BD has no application because it applies only in the case where the Assessing Officer assessing the Firm as well as the assessee is different. TheAssessing Officer had rightly issued the notice u/s. 158BC both upon the firm as well as upon the assessee which had resulted in the draft assessment and the proceedings on the basis of the notice u/s. 158BD are not valid and therefore, the proceedings u/s. 158BD were clearly invalid and without jurisdiction.

4. Rejecting the contention of the assessee and dismissing the appeal, the Supreme Court held as under:

"8. .....It can be seen that notice under Section 158BD can be issued to a person with respect to whom search was not conducted but undisclosed income was found as belonging to such person from the material seized from the residence or business premises of the person with respect to whom search was made under Section 132. Section 158BD speaks of the condition that "where the Assessing Officer is satisfied that any undisclosed income belongs to any person other than the searched person", which means that the Assessing Officer must have to be satisfied that any undisclosed income belongs to any person other than the searched person.In the present case, it is not in dispute that the Assessing Officer, who is assessing the firm as well as the Appellant, is the same person. In other words, the same Assessing Officer having jurisdiction over the searched person can proceed against the present appellant. Therefore, the present Assessing Officer had jurisdiction to proceed against the present Appellant to make a block assessment under Chapter XIV-B of the IT Act, in case the Assessing Officer is prima facie satisfied that any undisclosed income belongs to the present appellant."

"9) It is well settled that there must be prima facie satisfaction on the part of the Assessing Officer on the basis of searched books of account or other documents or assets that any undisclosed income belongs to any person other than the searched person. In support of the contention that there was prima facie satisfaction of the Assessing Officer, his order was based upon the material on record that undisclosed income belonged to the present appellant, when he issued the notice under Section 158BC on 9-9-1999.The jurisdiction under Section 158BD is based on the satisfaction of the Assessing Officer that:-

(a) there is undisclosed income;

(b) such undisclosed income does not belong to the person with respect to whom action under Section 132 was taken; and

(c) such undisclosed income belongs to some other person.

Therefore, mere disclosure made by the present assessee before the authority cannot be the basis for reaching a satisfaction that any undisclosed income belongs to him unless the seized books of account or other documents or assets are perused, examined or verified by the concerned Assessing Officer. We are of the opinion that in the present case, only after being satisfied that the appellant fell within the ambit of Section 158BD, a notice was issued by the Assessing Officer."

"10) Further, on a conjoint reading of Sections 158BC and 158BD, it is clear that no satisfaction to the effect that undisclosed income belongs to the searched person is necessary before issuing the notice under Section 158BC against the searched person as Section 158BC speaks of a condition that where any search had been conducted under Section 132 or books of account or other documents

or assets or requisition under Section 132A in case of any person, then, the Assessing Officer shall serve notice to such person requiring him to furnish within specified time a return in the prescribed form. Therefore, at the time when notice under Section 158BC was issued by the Assessing Officer to M/s. Nitya Kali Rice Mill, it was not necessary for the Assessing Officer to arrive at a satisfaction that any undisclosed income belongs to M/s. Nitya Kali Rice Mill.A search was conducted against M/s. Nitya Kali Rice Mill under Section 132 of the IT Act. Since the notice under Section 158BC issued to M/s Nitya Kali Rice Mill and the notice under Section 158BC issued to the Appellant were on the same day i.e., on 9-9-1999, the question of coming to a satisfaction that any undisclosed income based on seized books of accounts or documents or assets belonged to the present Appellant did or could not arise inasmuch as no reasonable or prudent man can come to such satisfaction unless the seized books of account or documents or assets are perused, examined and verified. Therefore, the Assessing Officer was right in arriving at a decision that the notice under Section 158BC issued to the present Appellant on 9-9-1999 did not satisfy the requirement of Section 158BD of the IT Act. He, therefore, rightly proceeded to issue fresh notice (Second Notice) under Section 158BD on 20-11-2000 after recording a satisfaction that any undisclosed income based on seized books of account or document or assets or other materials may belong to the Appellant. In fact, in the present case, the AO has himself come to a conclusion that the notice issued under Section 158BC on 9-9-1999 to the assessee was not in conformity with the requirement of Section 158BD of the IT Act. The Assessing Officer proceeded under Section 158BD of the IT Act not in pursuance of any direction by the Joint Commissioner but after being satisfied that the case squarely fell within the ambit of Section 158BD of the IT Act."

"11) A perusal of Section 158BD of the IT Act makes it clear that the Assessing Officer needs to satisfy himself that the undisclosed income belongs to any person other than the person with respect to whom the search was made under Section 132 or whose books of account or other documents or assets were requisitioned under Section 132A. The very object of the Section 158BD is to give jurisdiction to the Assessing Officer to proceed against any person other than the person against whom a search warrant is issued. Although Section 158BD does not speak of 'recording of reasons' as postulated in Section 148, but since proceedings under Section 158BD may have monetary implications, such satisfaction must reveal mental and dispassionate thought process of the Assessing Officer in arriving at a conclusion and must contain reasons which should be the basis of initiating the proceedings under Section 158BD."

An assessee can only be taxed on "real income". The bifurcation of lease rental is not an artificial calculation. Lease equalisation is an essential step in the accounting process to ensure that real income from the transaction in the form of revenue receipts only is charged to income tax. The Guidance Note issued by the ICAI carries weight and the method of accounting prescribed in such a Guidance Note, in order to compute real income and offering the same for taxation, cannot be disregarded by the AO unless such action falls within the scope and ambit of Section 145(3) of the Act

CIT vs. Virtual Soft Systems Ltd. Civil Appeal No. 4358 of 2018 dated 24th April, 2018

1. In this case, the assessee was a company registered under the provisions of the Companies Act, 1956. The assessee filed its return of income declaring loss while claiming certain amount as deduction for lease equalization charges.

The case was selected for scrutiny and the Assessing Officer in the assessment order

disallowed the deduction claimed and added the same to the income of the assessee. On appeal, the CIT(A) dismissed the appeal.

On further appeal, the Tribunal allowed the appeal of the assessee by setting aside the orders of the AO and the CIT(A).

Revenue, appealed to the High Court which was dismissed by the High Court at the preliminary stage.

2. The issue before the Supreme Court was whether the deduction on account of lease equalization charges from lease rental income could be allowed under the Act on the basis of Guidance Note issued by the Institute of Chartered Accountants of India (ICAI)?

3. The lease equalisation charge is an additional deduction debited to Profit and Loss Account (P&L) in addition to the depreciation claimed in the books so as to make it equal to capital recovery. This is an artificial calculation which bifurcates lease rental to capital recovery and interest component. The counsel for the Revenue contended that the entire lease income constituted income of the assessee. There was no concept of deduction regarding the lease equalisation charges under the IT Act. Hence, the impugned decision of the High Court was perverse and was liable to be set aside.

The Respondent assessee submitted that it was a settled principle that a Guidance Note issued by the ICAI carried great weight and by adopting a method of accounting prescribed in such a Guidance Note, in order to compute real income and offering the same for taxation, could not be disregarded by the Assessing Officer unless such action fell within the scope and ambit of Section 145(3) of the IT Act. It was submitted that the lease equalisation charge was nothing but a method of adjusting the depreciation claimed in the books of account to enable the assessee to represent its real income by adopting an accounting methodology which had surely the seal of approval of a professional body such as the ICAI.

4. The Supreme Court dismissed the appeal of the Revenue. The Supreme Court considered the amended Section 211 of the Companies Act, 1956 and held as under:

"10) The purpose behind the amendment in Section 211 of the Companies Act, 1956 was to give clear sight that the accounting standards, as prescribed by the ICAI, shall prevail until the accounting standards are prescribed by the Central Government under this sub-section. The purpose behind the accounting standards was to arrive at a computation of real income after adjusting the permissible deprecation. It is not disputed that these accounting standards are made by the body of experts after extensive study and research."

5. The Supreme Court thereafter considered the provision of the Guidance Note on Accounting for Leases, revised in 1995 and held as under:

"12) At the first look, it appears that the method of accounting provided in the Guidance Note of 1995, on the one hand, adjusts the inflated cost of interest of the assets in the balance sheet. Secondly, it captures "real income" by separating the element of capital recovery (essentially representing repayment of principal amount by the lessee, the principal amount being the net investment in the lease), and the finance income, which is the revenue receipt of the lessor as remuneration/reward for the lessor's investment. As per the Guidance Note, the annual lease charge represents recovery of the net investment/fair value of the asset lease term. The finance income reflects a constant periodic rate of return on the net investment of the lessor outstanding in respect of the finance lease. While the finance income represents a revenue receipt to be included in income for the purpose of taxation, the capital recovery element (annual lease charge) is not classifiable as income, as it is not, in essence, a revenue receipt chargeable to income tax."

"13) The method of accounting followed, as derived from the ICAI's Guidance Note, is a valid method of capturing real income based on the substance of finance lease transaction. The rule of substance over form is a fundamental principle of accounting, and is in fact, incorporated in the ICAI's Accounting Standards on Disclosure of Accounting Policies being accounting standards which is a kind of guideline for accounting periods starting from 1-4-1991. It is a cardinal principle of law that the difference between capital recovery and interest or finance income is essential for accounting for such a transaction with reference to its substance. If the same was not carried out, the Respondent would be assessed for income tax not merely on revenue receipts but also on non-revenue items which is completely contrary to the principles of the IT Act and to its Scheme and spirit."

"14) The bifurcation of the lease rental is, by no stretch of imagination, an artificial calculation and, therefore, lease equalisation is an essential step in the accounting process to ensure that real income from the transaction in the form of revenue receipts only is captured for the purposes of income tax. Moreover, we do not find any express bar in the IT Act which bars the bifurcation of the lease rental. This bifurcation is analogous to the manner in which a bank would treat an EMI payment made by the debtor on a loan advanced by the bank. The repayment of principal would be a balance sheet item and not a revenue item. Only the interest earned would be a revenue receipt chargeable to income tax. Hence, we do not find any force in the contentions of the Revenue that whole revenue from lease shall be subjected to tax under the IT Act."

6. The Supreme Court referred to the decision in the case of *CIT vs. Punjab Stainless Steel Industries (2014) 15 SCC 129* wherein the context of exploring the meaning of the word 'turnover' it was held that when a recognised body of accountants, after due deliberation and consideration publishes certain material for its members, one can rely upon the same.

7. The Supreme Court thereafter held as under:

"16) In the present case, the relevant Assessment Year is 1999-2000. The main contention of the Revenue is that the Respondent cannot be allowed to claim deduction regarding lease equalisation charges since as such there is no express provision regarding such deduction in the IT Act. However, it is apt to note here that the Respondent can be charged only on real income which can be calculated only after applying the prescribed method. The IT Act is silent on such deduction. For such calculation, it is obvious that the Respondent has to take course of Guidance Note prescribed by the ICAI if it is available. Only after applying such method which is prescribed in the Guidance Note, the Respondent can show fair and real income which is liable to tax under the IT Act. Therefore, it is wrong to say that the Respondent claimed deduction by virtue of Guidance Note rather it only applied the method of bifurcation as prescribed by the expert team of ICAI. Further, a conjoint reading of Section 145 of the IT Act read with Section 211 (unamended) of the Companies Act makes it clear that the Respondent is entitled to do such bifurcation and in our view there is no illegality in such bifurcation as it is according to the principles of law. Moreover, the rule of interpretation says that when internal aid is not available then for the proper interpretation of the Statute, the Court may take the help of external aid. If a term is not defined in a Statute then its meaning can be taken as is prevalent in ordinary or commercial parlance. Hence, we do not find any force in the contentions of the Revenue that the accounting standards prescribed by the Guidance Note cannot be used to bifurcate the lease rental to reach the real income for the purpose of tax under the IT Act."

"17) To sum up, we are of the view that the Respondent is entitled for bifurcation of lease rental as per the accounting standards prescribed by the ICAI. Moreover, there is no express bar in the IT Act regarding the application of such accounting standards."

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Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES
High Court

1. Export oriented undertaking u/s. 10B of the Income-tax Act, 1961 – Assessee a garment exporter was carrying out the activity of ironing, packing, affixing barcode labels, emblem graphics, affixing stickers, putting silica gel pouch inside packets, putting heat treated emblem on some of garments – assessee's activities fall within the definition of 'manufacturing' – exemption u/s. 10B allowed. [AY 2004-05]

Pr. CIT vs. A. P. Export [2018] 95 taxmann.com 169 (Calcutta)

The assessee was a private limited company engaged in the business of export of garments. It carried out various activities such as ironing, packing, affixing barcode labels, emblem graphics, affixing stickers, putting silica gel pouch inside packets, putting heat treated emblem on some of garments etc. In the return of income filed for the assessment year 2004-05 assessee claimed exemption u/s. 10B of the Act in respect of above activities. The AO disallowed the claim of the assessee on the ground that activities did not amount to manufacture or produce of any article or thing in course of its export. The learned CIT(A) accepted the contention of the assessee and deleted the disallowance made by AO. The Tribunal upheld the order of the learned CIT(A). On further appeal, the High Court observed that the definition of the term "manufacture" given in clause 9.32 of rules and regulations relating to EOU framed by the Government of India leans in favour of the assessee. It is the admitted position and also the finding on facts by the CIT (A) and the Tribunal that the assessee performed some functions on the garments received by it though all functions were not performed on all the garments but some or the other functions were performed on the garments received by the assessee. The definition as aforesaid includes repacking, reconditioning, refurbishing etc. and it goes to the extent of refrigeration. This shows that the definition of manufacture is very wide and includes a large number of functions and activities. The fact-finding authorities below noted the functions performed by the assessee and the expenses incurred for functions performed were reflected in the books of account which were verified by the AO. Further, nothing is found from the finding on facts by the CIT(A) and the Tribunal which can be termed as perverse. The Tribunal order was upheld.

2. Reassessment – Notice under section 148 issued after 4 years without mentioning in the reasons recorded that income escaped assessment

is ₹ 1 lakh or more – Proceeding pursuant to above notice not valid. [A.Y. 2006-07]

Novo Nordisk India (P.) Ltd. vs. Dy. CIT [2018] 95 taxmann.com 225 (Karnataka)

The assessee was a company engaged in the business of distribution of market products in relation to diabetes care, growth disorders and homeostasis and providing administrative and co-ordination services to its group companies. The AO had finalised the assessment order for AY 2006-07 under section 143(3) of the Act. Reference was also made to TPO who accepted the transactions at ALP. However, the AO, after lapse of close to six years from the end of relevant assessment year, by the impugned notice dated 28-3-2013 issued under section 148 of the Act initiated re-assessment proceedings on the ground that the income of the assessee for the relevant year had escaped assessment. The assessee challenged the notice issued under section 148 of the Act before the Hon'ble Karnataka High Court on the ground that the proceedings initiated were contrary to the statutory requirements as envisaged under clause (b) of sub-section (1) of section 149 of the Act.

The High Court held that it is mandatory for the Assessing Officer in his reasons recorded, to state that the escaped assessment amounts to, or is likely to be ₹ 1,00,000/- or more, to bring it within the ambit of Section 149(1)(b) of the Act. It is based on the reasons assigned by the Assessing Officer, the Commissioner/Sanctioning Authority on application of mind can take a decision whether it is a fit case for issuance of notice under Section 148. The material aspect for invoking the extended period of limitation under Section 149 (1)(b) not being forthcoming, further proceedings in pursuance to the said notice cannot be sustained. The notice issued being not in conformity with the provisions of the Act, it being the base or the foundation, edifice built upon it, has to fall. The writ petition was allowed and notice was quashed.

3. Settlement Commission order u/s. 245D – failure to full and true disclosure – Revenue to prove there was non-disclosure of facts and mere non-acceptance of claims not sufficient

Shreem Engineering Industries vs. ITSC (2018) 95 taxmann.com 190 (Bombay)

Assessee had filed applications before the Settlement Commission which were rejected by it under section 245(D)(4) of the Act on the ground that there was failure to make a full and true disclosure of its income on the part of the petitioner. The failure to disclose was on account of retention money, purchase of steel, sub-contracting and sales commission. On a Writ petition challenging the said rejection by the Settlement Commission this the Hon'ble High Court held that an High Court would interfere with the orders of the Settlement Commission only when it is contrary to law, perverse or the decision making process is flawed. In this case, the Court was of the *prima facie* view that the basis of rejection is contrary to law laid down by jurisdictional High Court. Non-acceptance of the claim would not *ipso-facto* lead to making the application for settlement bad for failure to make full and true disclosure of income. In fact to establish there was failure to make a full and true disclosure of income as required under Section 254(C)(1) of the Act, it would be necessary for the Revenue to prove that there was a non-disclosure of primary facts and not merely non-acceptance of certain claims made before the Commission.

Note:

The Hon'ble High Court emphasised on the fact that in order for an application to be maintainable what is essential is the disclosure of the primary facts only and not the acceptance by the Settlement Commission of all claims made in the said application as to the non-taxability of certain items.

4. Filing of return u/s. 139 – Linkage of Aadhaar card registration or enrolment number

Shreyasen vs. UOI – [W.P.(C) 7444/2018, C.M. Appl. No. 28499/2018, Delhi High Court order dated 24-7-2018]

A writ was filed seeking permission to file their returns without linking their Aadhaar Card to the PAN. It was also urged that despite the extension of time line up to 31-3-2019, the Income Tax Department has been sending e-mails / notices advising the assessees to link their Aadhaar number to PAN. On hearing the petition, the Hon'ble High Court held that the petitioners shall be permitted to file their returns, for AY 2018-19, without any insistence of linkage of their Aadhaar and PAN numbers and without insistence of production of their proof of Aadhaar enrolment. In case the returns are filed within the time prescribed by law, without such linkage, they shall be processed in accordance with law and in accordance with CBDT circular dated 27-3-2018 as extended on 30-6-2018. The Court observed that even after the CBDT Circular of 30-6-2018, which in effect suspended the requirement of Aadhaar linkage with PAN, for one year i.e. up to 31-3-2019, emails have been received from the Income Tax Authorities indicating that, in respect of the grievances like in the present case, parties have to approach the Court. The Court held that at least for the period till 31-3-2019, the CBDT shall issue an appropriate direction, and also create a platform by amending the digital form of substituting them properly to enable "opt out" from the mandatory requirement of having to furnish Aadhaar Registration or Aadhaar linkage, for the duration, the exemption subsists i.e. till 31-3-2019.

Note:

The Hon'ble High Court has relied upon its decision in the case of Mukul Talwar vs. UOI – W.P. (C) No. 3212/2018 & that of the Punjab and Haryana High Court in Pardeep Kumar vs. UOI – CWP 7672/2018 wherein similar directions were issued.

5. Income u/s. 2(24) – Capital vs. Revenue – Power subsidy given by State Government, available only to new units and units which had undergone expansion – Capital subsidy not liable to tax

PCIT vs. Shyam Steel Industries Ltd. (2018) 93 Taxmann.com 495 (Calcutta)

The question before the Hon'ble High Court was whether a subsidy allowed by the State Government on account of power consumption, by its very nature, will make the subsidy a revenue receipt and not a capital receipt, irrespective of the purpose of the scheme under which such incentive or subsidy is made available to a business unit. Before the Tribunal, there was a difference of opinion between the judicial member and the accountant member. The judicial member relied on *Sahney Steel & Press Works vs. CIT [1997] 228 ITR 253 (SC)* whereas the accountant member, relied on *CIT vs. Ponni Sugars & Chemicals Ltd. [2008] 306 ITR 392 (SC)* to hold that the purpose of the grant of the subsidy would be the overwhelming consideration in ascertaining whether the subsidy or the money was to be treated as a capital receipt or as a revenue receipt. Upon the difference being referred to a Third Member, the assessee's point of view was accepted and the purpose of the scheme was regarded to be one for setting up a new unit or expanding an existing unit and, as such, the subsidy had to be treated as a capital receipt notwithstanding the mode and manner of the subsidy. Thereafter, this appeal was filed by the Department. The Hon'ble High Court observed that the sweep of the "purpose test" has been expanded in a recent judgment of the Supreme Court in *CIT vs. Chaphalkar Brothers [2017] 400 ITR 279* where the subsidy in the form of exemption from payment of entertainment duty by newly set-up multiplex theatres for a certain number of years was regarded as a capital receipt by virtue of the very nature and purpose of the subsidy. It was argued that the incentive under the present scheme was in lieu of certain other subsidies on account of capital expenditure which may have been obtained by an assessee, the real purpose of the scheme has to be seen as augmenting the capital resources by a new or expanded unit and not to allow a lower cost of the daily functioning of an existing unit. To this the Court observed that the difference may be in degrees but the words of a scheme and the real purpose thereof have to be discerned in assessing whether the incentive or the subsidy thereunder has to be regarded as a capital receipt or a revenue receipt. There may be a scheme, for instance, that permits every entity of a certain class to lower charges for consumption of power, irrespective of the unit being a new unit or it having expanded itself. In such a scenario, the

incentive would have to be invariably regarded as a revenue receipt. However, when the scheme itself makes the incentive applicable only to new and expanding units, the fact that the incentive is in the form of a rebate by way of sales tax or concessional charges on account of use of power or a lower rate of duty being made applicable would be of little or no relevance. The Court held that when an entrepreneur sets up a business unit, particularly a manufacturing unit, or embarks on an exercise for expanding an existing unit, the entrepreneur factors in the cost of setting up the unit or the cost of its expansion and the costs to be incurred in running the unit or the expanded unit. It is the totality of the capital expenditure and the expenses to run it that are taken into account by the entrepreneur. The investment by an entrepreneur by way of capital expenditure is recovered over a period of time and has a gestation gap. If the running expenses are made cheaper by way of any subsidy or incentive and made applicable only to new units or expanded units, the realisation of the capital investment is quicker and the decision as to the quantum of capital investment is influenced thereby. That is the exact scenario in the present case where the lower operational costs by way of subsidy on consumption of power helps in the quicker realisation of the capital expenditure or the servicing the debt incurred for such purpose. The Court thus held that Supreme Court in most of its recent judgments has accepted the wider ambit of the "purpose test" and the scheme in this case being available only to new units and units which have undergone an expansion, the real purpose of the incentive in this case has to be seen as a capital subsidy and has to be regarded, as such, as a capital receipt and not a revenue receipt.

6. Income from other sources u/s. 56(2) vs. Cash credit u/s. 68 – Share premium over and above share value can be taxed u/s. 56(2) even if the AO is satisfied u/s. 68

Sunrise Academy of Medical Specialties (India) Pvt. Ltd. vs. ITO (2018) 96 taxmann.com 43 (Kerala)

The assessee is a private limited company. During AY 2015-16, it received share premium a sum of ₹ 2,13,92,000/- on allotment of shares of face value of ₹ 100/- each at a premium of ₹ 291/- per share. The case was picked up for limited scrutiny to check whether the funds received by the petitioner in the form of share premium are from disclosed sources and whether the same have been correctly offered for tax. The assessee filed details to prove that share premium received was from disclosed sources. Later the AO issued notice stating that the FMV of share is only ₹ 100/- and therefore share premium of ₹ 291/- is liable to be taxed u/s. 56(2) (viib). The assessee challenged the assessment order directly before the High Court by filing writ petition on the ground that the assessment was without jurisdiction. The writ petition was dismissed by a Single judge and the assessee filed appeal before the division bench. The court observed that there are two limbs to the notice; one as to the source and the other as to the amounts being correctly offered for tax. The Single had held that the attempt to tax the premium received was under the second limb. There could not have been any other reasonable view possible or a valid cause to have a different opinion on the words employed in the notice. The Court further observed that any premium received by a Company on sale of shares, in excess of its face value; if the Company is not one in which the public has substantial interest, would be treated as income from other sources, as seen from Section 56(2) (viib) of the Act, which cannot be controlled by the provisions of Section 68 of the Act. Section 68 on the other hand, as substituted with the provisos, treats any credit in the books of accounts, even by way of allotment of shares; for which no satisfactory explanation is offered, to be liable to income-tax. Clause (viib) of Section 56(2) is triggered at the stage of computation of income itself when the share application money received, from a resident, by a Company, in which the public are not substantially interested; is above the face value. If Section 68 is applicable, and the proviso is not satisfied, then the entire amounts credited to the books would be treated as income. If satisfactory explanation is offered as to the source, then only premium paid as revealed from the books will be brought to tax as income from other sources. The appeal was dismissed.

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Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES
Tribunal

Reported Decisions

1. Sec 50 : Capital Gains on Depreciable assets –– no addition can be made under the head Short Term Capital Gains when the block of assets does not cease to exist.

M/s. Amratlal Ashokkumar & Co. vs. ACIT, Circle (18) 1, Mumbai (ITA6689/Mum/2016)[Assessment Year: 2013-14] order dated 31.05.2018

Facts

The assessee is a Partnership Firm. It filed its return of income on 19.03.2013 declaring the total income at ₹ 37,14,050/-. During the year under consideration, the assessee sold an existing asset and thereafter purchased another asset pertaining to the same block'. In the earlier year i.e. A.Y. 2012-13, the assessee classified the asset sold during the year under the block entitled for depreciation at the rate of 10%. However, inadvertently for all the earlier assessment years prior to the Assessment Year 2012-13, the asset was included in the block of asset entitled at the rate of 5% and consistently the depreciation was charged at the rate of 5% on the asset sold by the Assessee for the year under consideration. During the course of assessment proceedings, the A.O. denied the existence of the said asset in the block of asset pertaining to depreciation at the rate of 10% and brought it back to the block of asset entitled for depreciation at the rate of 5%. Since there was no other asset in the 5% block, the AO made a computation u/s 50 of the Act. Aggrieved by the action of the AO, the Assessee preferred an appeal before the CIT (A) who confirmed the action of the AO The assessee, thereafter filed an appeal before ITAT. After considering the arguments of the both parties and perusing the material on record, ITAT held as under:

Held

The Appellate Tribunal observed that once the classification of the Asset was accepted by the Revenue and the depreciation was allowed at the rate of 10% for the immediately preceding assessment year, it was not open for the revenue to take a different stand in the subsequent assessment year when the part of the block was sold. It further observed that the AO was not correct to reclassify the asset in the block entitled for the depreciation at the rate of 5% in the facts under consideration. It held that since the Assessee purchased another asset pertaining to the block out of which one asset was sold, nothing could be taxed u/s. 50 of the Act as the block continued to

exist. Further, Hon'ble ITAT distinguished the decision relied upon by the DR in the case of *"CIT vs. M/s. T.S. Mishan & Co. Ltd." (ITA No. 1270 of 2011 dated 16.09.2014)* on the observation that it has no applicability in the light of the fact that the revenue had already accepted in the immediate preceding assessment year that the asset sold during the year under consideration pertained to the block entitled for depreciation at the rate of 10% . On the aforesaid observations, Hon'ble ITAT held in favour of the Assessee and against the Revenue.

2. Section 54F r.w.s. 50C : Deduction – When the Assessee invested the entire sale consideration in new house property and claimed an exemption u/s. 54F of the Act, the Ld. AO cannot apply section 50C of the Act to treat the stamp duty valuation as the full value of consideration

ITO vs. Shri Rajkumar Parashar (ITA 11/JP/2016) (Assessment Year: 2011-12) order dated 28.09.2017

Facts

The assessee is an individual. During the year under consideration, the assessee sold the property situated at Ajmer for the total consideration of ₹ 25,60,000/-. The Sub-registrar adopted the value of property at ₹ 96,03,000/-. Since, the sale value was not disclosed by the assessee the reassessment proceedings were initiated u/s. 148 of the Act. During the course of re-assessment proceedings, the assessee submitted that the entire amount of the sale consideration was invested in the capital gain account scheme for the purposes of purchasing a new house property and urged that the entire capital gains would be exempted u/s. 54F of the Act without any applicability of sec 50C of the Act. The Ld. A.O. while passing the assessment order u/s. 143(3) r.w.s 147 of the Act considered the value adopted by stamp duty authorities for the purpose of full value of consideration and made the addition of ₹ 70,00,800/- under the head "LTCG" after giving a deduction u/s. 54F of the Act. The assessee, then, preferred the appeal before the. CIT(A). The CIT(A) allowed the appeal of the assessee by observing that the provisions of Sec. 50C(1) are not applicable to section 54F for the purpose of determining full value of the consideration. It was held that the deduction in respect of 54F, admissible to the appellant has to be computed on the basis of full value of consideration specified in the sale deed and not as per deeming fiction. Being aggrieved by the said order, the Revenue preferred the appeal before Hon'ble ITAT. After considering the arguments of both the parties and perusing the records, Hon'ble ITAT held as under.

Held

The Appellate Tribunal observed that it was clear that the net consideration for the purposes of section 54F of the Act has been defined as the full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer. In other words, the consideration which is actually received or accrued as a result of transfer has to be invested in the new asset. Hon'ble ITAT observed that in the instant case, the consideration which accrued to the assessee as per the sale deed was invested in the capital gains accounts scheme for purchase of the new house property and therefore there is no applicability of sec 50C of the Act. In addition thereto, it categorically found that the provisions of section 54F(1)(a) were fully complied with by the Assessee in the facts under consideration and upheld the action of the . CIT(A). The case was decided in favour of the Assessee and against the Revenue.

3. Section 28 : Income from Business – If the object of lease is to allow enjoyment of entire property with all related services to its use, i.e. leasing space and maintenance services, the entire income from the activities is chargeable as income from business

Ambattur Infra Developers vs. DY.CIT (ITA No. 195 & 196/Chenn/2016 and 376 & 377/ Chenn/2016), order dated 23/07/2018

Facts

The Assessee is a partnership firm and engaged in business of building, selling and leasing out Information Technology parks. During the year under consideration, the Assessee had given out on rent "IT Park" to various parties along with several amenities and separate two agreements were entered into by the Assessee with every lessee to that effect. During the course of assessment proceedings, the . AO noted that the assessee had received rental receipts as well as maintenance charges from the said lessees, and a deduction u/s. 194I of the Act was made on the said payments made to the Assessee. The . AO therefore taxed the entire income under head "income from house property". Aggrieved by the same, the Assessee preferred an appeal before the . CIT(A) who partly upheld the order of the . AO and taxed the lease rental income under the head income from house property. However on the other hand, he allowed the claim of the assessee by taxing the maintenance and service charges received by it as income from business. Aggrieved by the same, the Assessee as well as the Revenue preferred appeals before Hon'ble ITAT.

Held

The Appellate Tribunal observed that the main object of lease was to allow enjoyment of entire property with all services related to its use as technology centre. It further held that since all the agreements were entered into contemporaneously and the overall object was to enjoy the entire property viz: building, furniture and the accessories as a whole which was necessary for carrying on the business, the income derived from the entire activity cannot be bifurcated merely on the fact that separate agreements were entered into. Hon'ble ITAT relied upon various judicial pronouncements of Hon'ble High Courts and Hon'ble Apex Court and concluded that the entire income must be taxed as income from business in the facts under consideration by holding it in favour of the Assessee and against the Revenue.

4. Section 56(2)(viia): Income From Other Sources –-There is no applicability of section 56(2)(viia) of the Act in case of buy back of shares by the Company from its existing shareholder

M/s. Vora Financial Services Pvt. Ltd. vs. ACIT – 2(3)(1), Mumbai (ITA 532/Mum/2018)[Assessment Year: 2014-15] order dated 29.06.2018

Facts

The assessee is a Private Limited Company and engaged in the business trading in shares and derivatives. During the year under consideration, the assessee Company made an offer to its existing shareholders for buy back of 25% of their existing shareholding at a price of ₹ 26/- per share. The offer was opened from 8th May, 2013 to 22nd May, 2013. To avail benefits of the said offer, one of the directors Shri Kashyap Vora offered 12,19,075 shares held by him under the said buyback scheme and accordingly the assessee bought the said shares by paying the total consideration of ₹ 316.95 Lakhs to Shri Kashyap Vora on 24.05.2013. During the course of assessment proceedings the Ld. A.O.

Observed that the book value of the shares transferred in the scheme of buy back was ₹ 32.80 per share which was less than the buyback price and accordingly brought the difference to tax u/s. 56(2)(viia) of the Act. On appeal, the Ld. CIT(A) confirmed the addition made by the Ld.A.O. The assessee being aggrieved by the same preferred an appeal before Hon'ble ITAT. After considering the contentions of both the parties and perusing the provision of sec 56(2)(viia) of the Act, it held as under:

Held

Hon'ble ITAT while deciding the issue of applicability of the provision of section 56(2)(viia) of the Act referred to the Memorandum explaining the said provision and observed that a combined reading of the said provision and the memorandum suggests that the provision has role to play only when the subject matter (i.e. shares) is of other company and not of the same company who receives it. Hon'ble ITAT categorically observed that own shares cannot become a property of the recipient company for the applicability of section 56(2)(viia) of the Act and cannot be brought to tax. It categorically held that if the present situation of buy back of shares were to be taxed u/s 56(2)(viia) of the Act, the language of the section would have been completely different. It finally concluded that there is no applicability of section 56(2)(viia) of the Act to the facts under consideration and allowed the issue in favour of the Assessee and against the Revenue.

5. Interest income from fixed deposits must be netted off against pre-operative expenses incurred in connection with setting up of its project where the fixed deposits are raised by the assessee solely with the intention of utilizing them in setting up its project.

Shristi Hotel Pvt. Ltd. vs. Dy.CIT, (ITA No. 395/Kol/2018) order dated 18/07/2018

Facts

The Assessee was incorporated for the purpose of carrying hotel business by establishing a five star hotel. During the year under consideration, the assessee company had credited income derived from Fixed Deposits. Further certain expenses were incurred in connection with the business and the net amount was offered to tax. During the course of assessment proceedings, the . AO disallowed the expenses on the observation that the business of the Assessee was not completely set up. Further he held that the said expenses were not allowable u/s 57(iii) of the Act since they were not incurred in earning the interest income from fixed deposits. Finally, the AO disallowed all the expenses and taxed the entire interest income under the head income from other sources. Aggrieved by the order, the Assessee preferred an appeal before the . CIT(A) who dismissed the same. Thereafter, the Assessee approached Hon'ble ITAT and placed its contentions. In addition thereto, the Assessee took an alternative plea and submitted that if the expenses were not allowable on the fact that business was yet to be set up, the interest income must be netted off against the said expenses and could not be held as a separate source of income. After perusing the records and hearing both the sides, Hon'ble ITAT held as under:

Held

The Appellate Tribunal observed that to reduce effective cost of setting up the hotel project, the Assessee had deployed temporary surplus funds in fixed deposits which yielded the interest income to the Assessee during the pre-commencement stage. It further observed that the assessee had undertaken concerted efforts to set up a five star hotel and each and every activity including the efforts taken for raising financial resources was aimed on

setting up the business of hotel. Hon'ble ITAT held that none of the activities of the assessee could be considered or viewed in isolation in the fact under consideration. On the aforesaid observations, Hon'ble ITAT accepted the alternate plea of the Assessee and held that the interest income must be netted off against pre-operation expenses and could not be taxed separately under the head income from other sources.

6. TDS Credit – The Assessee is entitled for TDS credits which were not claimed in the original return of income but were claimed before the Ld. A.O. during the course of rectification proceedings u/s. 154 of the Act provided a corresponding income was offered to tax and there was no mistake on the part of the Assessee with regard to not to claim the said TDS credits in the original return of income

M/s. Express Global Logistics Pvt. Ltd. vs. ACIT 2(1)(2), (ITA No: 1194/Mum/2017) [Assessment Year:2008-09] (Mum)(Trib), Order dated 11/07/2018

Facts

The Assessee is a private limited company. In the return of income for the year under consideration, the Assessee included certain income received from two parties. However, it did not claim corresponding credits of the "TDS" on the aforesaid income mainly on the reason that both the parties neither deposited the TDS amount to the treasury of the Government nor furnished TDS certificates to the Assessee at the time of filing the return of income. This entire compliance was done by the parties almost after one year from the end of the relevant Assessment year due to which the Assessee could not file a revised return and claim the said TDS credits I any other manner. Considering this difficulty, the Assessee first time claimed the said TDS credits before the Ld. A.O. by filing a letter in the course of rectification proceedings u/s. 154 of the Act. Along with the said letter, the Assessee submitted original TDS certificates and an affidavit pointing out the reason of its failure to claim the same in the original return of income. However, the Ld. A.O. did not allow the said TDS credits in the rectification order passed u/s. 154 of the Act. Aggrieved by the same, the Assessee filed an appeal before the Ld. CIT(A) who confirmed the order of the Ld. A.O. Aggrieved by the order of the Ld. CIT(A), the Assessee approached Hon'ble ITAT. After hearing both the parties and perusing the relevant records, Hon'ble ITAT held as under.

Held

The Appellate Tribunal observed that the Assessee could not claim TDS credits in the original return of income due to failure on the part of payers and there was no mistake of the Assessee in the same. It further observed that the said TDS credits ought to have been given by the Ld. A.O. when a corresponding income was offered to tax by the Assessee in its return of income. Hon'ble ITAT referred to article 265 of the constitution and judgements of co-ordinate benches relied upon by the Assessee and finally restored the matter to the file of the Ld. A.O. for a limited verification. The issue was allowed in favour of the Assessee.

Reported Decision

7. Depreciation on goodwill – The issue is no more res integra in view of the judgment of the Supreme court in "CIT v. Smifs Securities Ltd. [2012] 348 ITR 302 (SC)" in which it has been held that "goodwill falls under the expression 'or any other business or commercial rights of similar

nature''. The Assessee is entitled to claim depreciation on the same

CLC & Sons (P) Ltd. vs. ACIT circle 3(1), (ITA No: 1976/Del/2006)(SB) [Assessment Year: 2001-02] Order dated 19/07/2018

Facts

For the year under consideration, the Assessee took over all the assets and liabilities of M/s CLC & Sons, a partnership firm with effect from 01.04.2000. An agreement for transfer of all the assets and liabilities was signed between the Assessee and CLC & Sons on 11.02.2000. As per clause 2 of the said Agreement, all the assets in the books of the partnership firm were taken over by the assessee company at book value of ₹ 1,20,54,320/-. In addition, goodwill of the partnership firm was valued at ₹ 10 crore, which was also transferred to the assessee company. The Assessee claimed depreciation on the aforesaid goodwill while computing its income for the year. The Ld. AO denied a claim of depreciation mainly on two reasons. The first reason was that goodwill is not a depreciable asset. Further the second reason was that there was no transfer in the facts under consideration since the firm was succeeded by a company and all the partners became the shareholders of the company, which was promoted by the partners themselves. On appeal, the Ld. CIT(A) confirmed the stand taken by the Ld. AO. Aggrieved with the same, the Assessee preferred an appeal before Hon'ble ITAT.

Held

Considering contradictory views on the issue, the division bench made a reference to the Hon'ble President for constitution of a Special Bench on 31.08.2009 and accordingly the legal issue with regard to depreciation on goodwill was referred to the special bench. After perusing facts and judgements on the issue under consideration, the special bench came to the conclusion that the issue is covered in favour of the Assessee and against the Revenue by the decision of Hon'ble Apex Court in case of *"CIT v. Smifs Securities Ltd. [2012] 348 ITR 302 (SC)"* wherein it has been held that goodwill will fall under the expression "or any other business or commercial rights of similar nature" and qualifies for depreciation u/s. 32 of the Act. With regard to the second issue on transfer of goodwill under consideration, both the counsels for parties accepted that this issue was not referred to the special bench and in view of the same, the special bench sent the matter back to the division bench for disposal.

❍□❍

We are to put the chemicals together, the crystallisation will be done by nature according to her laws. Work hard, be steady, and have faithin the Lord.

— *Swami Vivekananda*

When you are doing any work, do not think of anything beyond. Do it as worship, as the highest worship, and devote your whole life to it for the time being.

— *Swami Vivekananda*


CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. Even after the Tribunal remands / restores the matter, it is mandatory for the AO to first pass draft assessment order

Dimension Data Asia Pacific PTE Ltd. vs. DCIT - Writ Petition No. 921 of 2018 (Bom.)

Facts

(i) In the case of the assessee-foreign company, a draft assessment order was passed on 20-3-2015 u/s. 144C(1) by the AO and consequent to the directions issued by the DRP, the AO passed the final assessment order on 11-1-2016 u/s. 143(3) r.w. section 144C(13) of the Act. On further appeal, Tribunal partially restored the matter back to AO *vide* its order dated 5-5-2017 for fresh adjudication on the issue of attribution of profits to Permanent Establishment (PE).

(ii) In remand proceedings, the AO passed a final order dated 31-1-2018 without passing a draft assessment order.

(iii) The assessee filed the present writ petition contending that the AO's order dated 31-1-2018 was without jurisdiction as it was in defiance of the mandate of passing a draft order u/s. 144C of the Act.

Held

(i) Noting that the assesse was a foreign company, the Court stated that the Parliament has provided a special/ separate procedure for passing assessment orders and appellate procedure thereupon for such assessee and accordingly, it held that the assessee was entitled to a draft assessment order being passed under Section 144(1) of the Act before the final assessment order.

(ii) It held that the AO by directly passing the final order dated 31-1-2018 has taken away the assessee's right to object to the draft assessment order before the DRP. In this regard, the Court relied on the decision of Co-ordinate Bench in the case of International Air Transport Association [(2016) 241 Taxman 249 (Bom.)] wherein the Court had quashed final assessment order made on foreign company was not preceded by a draft order.

(iii) It rejected the revenue's contention that the Tribunal's order did not set aside the original assessment order dated 11-1-2016 but merely restored the matter back to AO to give effect to its order (i.e., to determine profits attributable to PE in India) and therefore, there was no requirement to pass a draft assessment order. The Court relied on the decision in the case of *JCB India Ltd. vs. DCIT [2017] 85 taxmann.com 155 (Delhi)* wherein it was held that even in partial remand proceedings from the Tribunal, the AO is obliged to pass a draft assessment order u/s. 144C(1).

(iv) It held that, in terms of Section 144C of the Act, the AO is obliged to pass a draft assessment

order in all cases where he proposes to assess the foreign company under the Act by making a variation in the returned income and in the present case, the working out of the Tribunal order dated 5-5-2017 resulted in the returned income being varied. Thus, the procedure of passing a draft assessment order under Section 144C(1) was mandatory and had to be complied with.

(v) Further, the Court did not entertain the revenue's plea that the petition should be quashed as an alternate remedy of an appeal under the Act from the impugned order was available, since the impugned order itself was without jurisdiction.

(vi) Thus, the Court quashed the impugned draft assessment order dated 31-1-2018.

2. In case of reopening of assessment proceedings, AO can make a reference to the TPO only after rejecting the assessee's objections filed against the reopening by passing a speaking order

Alden Prepress Services Private Limited vs. DCIT - Writ Petition No.13815 of 2011 and WMP. Nos.7943 and 7944 of 2017 (Mad.)

Facts

(i) The Assessing Officer issued notice under Section 148 of the Act to reopen the assessment for AY 2008-09, in response to which the assessee sought the reasons for reopening.

(ii) The reasons for reopening stated that from the Transfer Pricing Report filed by the assessee as per Section 92E of the Act under Form 3CEB, it was seen that the ALP of the services rendered by the assessee to its parent company located in UK was more than the amount recorded for the same in the books of account and no adjustment was made by the assessee in this regard.

(iii) On receipt of the reasons for reopening, the assessee submitted its objections dated 26-4-2010 and while the objections were pending for disposal before the AO, the TPO issued notice dated 23-3-2011 under section 92CA(2) of the Act (requiring assessee to produce evidence on which it relied for computation of the ALP for the said international transaction).

(iv) The assessee filed the present Writ Petition against the notice issued by the TPO contending that the AO was bound to dispose of the objections raised by it *vide* letter dated 26-4-2010 and before the objections were disposed of, the TPO had no jurisdiction to issue the impugned notice.

Held

(i) It held that the AO had missed out the very important aspect with regard to powers exercisable by the AO and the powers exercisable by the TPO. The AO could refer the matter to the TPO only after disposing off the objections filed by the assessee by passing a speaking order in accordance with the decision in the case of *GKN Driveshafts (India) Ltd. vs. ITO (2003) 259 ITR 19 (SC).*

(ii) Thus, the Court disposed of the Writ Petition directing the TPO to keep the impugned notice in abeyance and further directing the AO to dispose off the assessee's objection by passing a speaking order and proceed in accordance with law.

3. No substantial question arises against the Tribunal's order wherein the Tribunal didn't allow the assessee's claim for market risk adjustment giving sufficient reason and following the view taken in an another case

Solidcore Techsoft Systems (India) Pvt. Ltd. vs. ITO – ITA No. 848/ 2017 (Kar.)

Facts

(i) The assessee-company claimed market risk adjustment placing reliance on Rule 10(3) of the Income-tax Rules, 1962 providing for an adjustment for risk differential.

(ii) However, the Tribunal didn't allow the assessee's above claim for market risk adjustment noting that the assessee itself had not given any details and computation of risk adjustment and thus, holding the assessee's claim to be hypothetical in nature.

(iii) For the above ratio, the Tribunal relied on the decision in the case of *Zyme Solutions Pvt. Ltd. vs. ITO [IT(TP)A No. 465/Bang/2015]* wherein the DRP had directed the TPO to give a risk adjustment on Profit Level Indicator (PLI) and the Tribunal, after noting that the assessee in its TP study had not made any attempt to quantify the risk rather it had mentioned the difficulties of attempting a risk adjustment, held that the risk perceived by the assessee was hypothetical which could not be factored in while working out PLI.

Held

The Court dismissed the assessee's appeal against the Tribunal order holding that no substantial question of law arose since the Tribunal had given sufficient reasons for not allowing any risk adjustment following its earlier view in the case of *Zyme Solutions Pvt. Ltd. vs. ITO (supra).*

4. For benchmarking interest received by the Indian company on loans given to its foreign AEs, LIBOR rate is acceptable

Pr. CIT vs. S B & T International Ltd. – ITA No. 66 of 2016 (Bom.)

Facts

(i) The assessee-company claimed that the interest on the loan provided by it to its AEs at Mauritius had to be benchmarked at US LIBOR (London Interbank Offered Rate) interest plus 2%.

(ii) The Tribunal accepted the assessee's above claim on the basis that the cost of funds for the AE's to whom the loan had been advanced by the assessee was to be measured by the rate of interest in Mauritius.

(iii) In this regard, the Tribunal followed the decision of its Co-Ordinate Bench in the case of *Aurionpro Solutions Ltd. vs. Addl. CIT (ITA No. 7872/Mum/2011)* wherein it was held that since for the purpose of determination of ALP, the tested party is always assessee and not AE, for benchmarking loans given by Indian company to its foreign AEs, LIBOR is acceptable instead of interest rates prevailing in India.

Held

(i) It was noted that when the appeal was by Revenue against the Tribunal's decision in the case of *Aurionpro Solutions Ltd. vs. Addl. CIT (ITA No.7872/Mum/2011),* the Court had rejected the appeal as it did not give rise to any substantial question of law.

(ii) Further, noting that there was no distinguishing feature pointed out as against the case of Aurionpro Solutions Ltd., relying on its order passed in the said case, the Court held that the question proposed did not give rise to any substantial question of law and, thus, it dismissed the present appeal also.

5. Picking of comparable, shortlisting them, application of filters, etc. for making Transfer Pricing Adjustment are all fact-finding exercises for which the final orders passed by the Tribunal are binding on the lower Authorities of the department as well as High Court and no substantial question of law arises therefrom unless the perversity of Tribunal's findings is established

Pr. CIT vs. Softbrands India (P.) Ltd – ITA Nos. 536 & 537 of 2015 (Kar.)

Facts

(i) Revenue filed an appeal before the High Court against the Tribunal's order wherein the Tribunal had rejected certain comparables adopted by the TPO/ AO by following its earlier order and fixed the Related Party Transaction (RPT) filter at 15% of total revenue and thus deleted certain other comparables in this regard.

Held

(i) The Court held that the entire exercise of making Transfer Pricing Adjustments on the basis of the comparables is nothing but a matter of estimate of a broad and fair guesswork of the Authorities based on relevant material brought before the Authorities including the Appellate Tribunal and such exercise should be allowed to become final with a quietus at the hands of the final fact-finding body, i.e. the Tribunal.

(ii) It held that unless the Court is satisfied that a substantial question of law is arising from the order of the Tribunal, the appeal under section 260-A cannot be entertained at the instance by either the Revenue or the assessee. A substantial question of law too arises as to maintain the appeal in these type of cases is possible only by establishing the perversity of the findings of the Tribunal on the basis of cogent material which was available before the Authorities below including the Tribunal.

(iii) The Court held that since, in the present case, the Tribunal had given cogent reasons and detailed findings upon discussing each case of comparable corporate properly and therefore, such findings of the Tribunal could not be called to be perverse in any manner so as to require interference under section 260-A

(iv) Further, it held that the extended power given to the High Courts to decide even an issue under sub-section (6) of section 260-A of the Act which provides that any issue which (a) has not been determined by the Tribunal or (b) has been wrongly determined by the Tribunal, can be so determined by the High Court, only if the High Court comes to the conclusion that 'by reason of the decision on substantial question of law rendered by it', such a determination of issue of fact also would be necessary and incidental to the answer given by it to the substantial question of law arising and formulated by it.

(v) After discussing the scheme of assessment of the Transfer Pricing Cases, the Court held that the Court cannot be expected to undertake the exercise of comparison of the comparables itself which is essentially a fact-finding exercise since neither the sufficient Data nor factual information nor any technical expertise is available with the Court to undertake any such fact-finding exercise in the appeals under section 260-A.

(vi) It held that unless the perversity of the findings of the Tribunal is duly established with the relevant evidence and facts, no other reasoning or for that matter, even the inconsistent view taken by the Tribunal in different cases depending upon the relevant facts available before it can lead to the formation of a substantial question of law in any particular case to determine the aspects of determination of 'Arm's Length Price'.

(vii) The Court held that the picking of comparables, shortlisting of them, applying of filters, etc., are all fact-finding exercises and therefore the final orders passed by the Tribunal are binding on the lower Authorities of the department as well as High Court. Thus, the Tribunal is expected to act fairly, reasonably and rationally and should scrupulously avoid perversity in their Orders. It should reflect due application of mind when they assign reasons for returning the particular findings. For instance, while dealing with comparables or Filters, if unequals like software giant Infosys or Wipro are compared to a newly established small size Company engaged in software service, it would obviously be wrong and perverse.

(viii) It held that if it had been a case of substantial question of interpretation of provisions of Double Taxation Avoidance Treaties (DTAA), interpretation of provisions of the Act or overriding effect of Treaties over Domestic Legislations or questions like Treaty Shopping, Base Erosion and Profit Shifting (BEPS), Transfer of Shares in Tax Havens, if based on relevant facts, such substantial questions of law could have been raised before High Court under section 260-A. However, the question as to whether comparables had been rightly picked or not, filters for arriving at correct list of comparables had been rightly picked or not do not give rise to any substantial question of law.

(ix) Thus, based on the above discussion, the Court held that the appeals filed by the Revenue do not give rise to any substantial question of law and, accordingly, dismissed the said appeals.

B. AUTHORITY FOR ADVANCE RULING (AAR)

6. AAR held that part of fees received/ to be received by the Applicant, a Singapore based company, engaged in processing of electronic payment transactions from Indian Customers would be classified as royalty, but the entire fees received by the applicant from Indian customer would be taxed under Article 7 and not under Article 12 since the same were effectively connected to PE considering *inter alia* that its Indian subsidiary owned and maintained MasterCard Interface Processor placed at Customers' locations in India

MasterCard Asia Pacific Pte. Ltd., In re. [2018] 94 taxmann.com 195 (AAR New Delhi)

Facts

(i) The applicant, a Singapore based company forming part of MasterCard group, was the regional headquarter for the Asia Pacific, Middle East and Africa [APMEA] region.

(ii) The services were provided by the Applicant to APMEA Customers pursuant to Master License Agreements ("MLA"), which the Applicant signs with each and every Customer in the APMEA region (including those based in India, pursuant to the proposed business operating mechanism to be adopted in India). Consequent to the terms of an MLA, the Applicant charged its Customers transaction processing fees relating to authorization, clearing and settlement of transactions. The Applicant also received assessment fees for building and maintaining a processing network that serves the needs of customers globally, for setting up and maintaining a set of rules that govern the authorization, clearing and settlement process for every payment transaction, so as to maintain the integrity and reputation of its network and also for guaranteeing settlement between the member banks/Customers for payment transactions processed by MasterCard. Additionally, it received miscellaneous revenue for the provision of services which were ancillary to the transaction processing activities e.g. warning bulletin fees for listing invalid or fraudulent accounts either electronically or in paper form, cardholder service fees, program management services (e.g. foreign exchange margin, commissions, load fees), account and transaction enhancement services, holograms and publication.

(iii) The transaction processing activity consisted of electronic processing of payments between banks of merchants ("Acquirer" or 'Acquirer bank") and banks of cardholders ("Issuer" or "Issuer bank") through the use of MasterCard Worldwide Network ("the Network"). The MasterCard Interface Processor ("MIP") that connects to MasterCard's Network and processing centers, was located at the customer location. The Network facilitates authorization, clearing and settlement of payment transactions and, thus, by linking the Issuers and Acquires around the globe for transaction processing services, permits MasterCard Cardholders to use their cards at millions of merchants worldwide.

(iv) The Applicant had a subsidiary in India, namely MasterCard India Services Private Limited ("Indian subsidiary"), in which it owned 99% of the shareholding. The remaining 1% was held by the Applicant's immediate holding company, MasterCard Singapore Holding Pte Ltd. The India subsidiary owned and maintained the MIPs placed at the Customers' locations in India.

On the above facts, the applicant sought a ruling from AAR on the following questions:

1. Whether on the facts and circumstances of the case, the Applicant has a Permanent

establishment (PE) in India under the provisions of Article 5 of the India-Singapore DTAA in respect of the services to be rendered with regard to use of a global network and infrastructure to process card payment transactions for Customers in India?

2. Without prejudice to the above, where a PE of the Applicant (in the form of its Indian subsidiary) is found to exist in India, whether provision of arm's length remuneration to such PE for the activities to be performed in India, would absolve any further attribution of the global profits of the Applicant in India?

3. Whether on the facts and circumstances of the case, the fees to be received by the Applicant from Indian Customers (comprising transaction processing fees, assessment fees and transaction related miscellaneous fees) would be chargeable to tax in India as royalty or fee for technical services (FTS) within the meaning of the term in Article 12 of the India-Singapore DTAA?

4. Based on the answers to the above questions, and in view of the facts as stated in the subsequent part of the Applicant, whether any tax withholding at source would be required on the amounts to be received by the Applicant?

Ruling

(i) AAR considered the question as to whether if the applicant had a PE in India, based on the various contentions raised by the revenue and the conclusion arrived with respect to the same are as under:

Whether MIPs constitutes fixed place PE for the applicant?

- AAR citied the three tests to be fulfilled to constitute a PE viz., permanency, a fixed place and disposal, as discussed in the decision of Formula *One World Championship Ltd. v. CIT (2017) 394 ITR 80 (SC)*
- It accepted revenue's stand that an automatic equipment can also create PE and to create a PE, it is not necessary that the equipment should be fixed to the ground.
- Noting the decision in the case of *DIT vs. E-Funds IT Solution and Ors. (2017) 399 ITR 34 (SC)* which required examining whether the functions performed by MIPs could be considered as significant functions, AAR held that the role played by MIPs was a significant one in facilitating authorization process, and without this initial verification/validation by MIPs, the authorization would not happen and thus the same could not be said to be preparatory or auxiliary.
- Further, it noted that though the MIPs are shown to be owned by Indian subsidiary MISPL, but since the MISPL was performing support activity and not actual transaction processing, the authorization part of the transaction processing activity, carried on by MIPs, was the activity of the Applicant and not of MISPL. It held that the MIPs were under the disposal of the Applicant since all risk mitigation functions were performed by it and all decisions with respect to MIPs were taken by it.
- Thus, AAR concluded that the Applicant was carrying out its business of facilitation of authorization of transaction through the fixed place, i.e. MIPs, since MIPs situated in India was at its disposal. The functions performed by MIPs in the facilitation of authorization transaction were not preparatory or auxiliary in character and were significant functions. Hence, MIPs created a PE of the Applicant in India.
- It factually distinguished the applicant's reliance on the Ruling of the Australian Taxation Office (ATO), wherein it was held by the ATO that the Applicant does not

have a PE in Australia on account of MIP, by observing that in the Australian case, MIPs were owned by a group company outside Australia and not transferred to the Australian subsidiary, transaction processing services were provided by that company and not the Applicant and thus the company owning MIPs got compensation for transaction processing.

MasterCard Network – whether constitutes fixed place PE?

- AAR noted that MIP was involved only in the authorization part of the transaction processing while the MasterCard Network was involved in all the three phases of transaction processing, i.e. authorisation, clearance and settlement. Thus, it held that examining whether MasterCard Network created a PE was relevant for profit attribution purposes.
- It rejected the Applicant's stand that the MasterCard Network was outside India and no part of it was in India. Referring to the TP report of MISPL for FY 2014-15, AAR noted that MIP was part of MasterCard Network and so were the transmission tower, leased lines, fiber optic cable, nodes and internet (owned by third party service provider), and application software - Master Connect and Master Card File express (owned by the Applicant), which were in India as well as outside India. Further, it observed that significant activities relating to clearance and settlement took place in India.
- It thus held that just like MIP, the network also passed the test of permanency and fixed place. It held that the network in India also passed the test of disposal noting that the Application software – Master Connect and Master Card File express were owned by the Applicant and controlled by them and that the network in India was secured by MasterCard to prevent fraud and to enhance security.
- It held that the task performed by MIP (preliminary verification/validation part of authorization and encryption of data), network in India (transmission of data), application software (sending and receiving data) were significant activities when seen in the context of overall functions of transaction processing rendered to a third party and not preparatory or auxiliary, since the overall activity of MasterCard was of transmission of signal amongst merchant and banks, and after securing them the third party was paying for such services.

Bank of India premises – whether fixed place PE?

- Noting that the final information comes to Bank of India (BOI) for passing the necessary entry in the banks account of both acquirer banks and issuer banks, it accepted revenue's contention that BOI space where settlement activity takes place through employees of BOI created a fixed place PE.

Applicant's subsidiary MISPL in India - whether fixed place PE?

- AAR noted that till December 2014, MCI (of which the applicant was a wholly owned indirect subsidiary) had a liaison office ('LO') in India, and MCI (through its overseas AE) owned MIPs which were placed in the premises of the Indian Customers. MCI had entered into licensing agreement with various Indian customers. Employees of LO were found to be performing more than preparatory and auxiliary services. In fact, for ten years prior to December 2014, the Applicant disclosed income from transaction processing service rendered in India at full 100% attribution at the global net profit rate. From December 2014, the Applicant had shut down the LO and had transferred that work to the Indian Subsidiary MISPL. The employees of LO were taken over by the Indian subsidiary and they continued to perform the same functions. Similarly, the work of MCI was transferred to the Applicant's Singapore

entity. So far as Indian customers (banks/ FIs) were concerned there was no effect on their activities.

- AAR highlighted that there were some functions and risks related to transaction processing which were earlier carried out by MCI in India and were still carried out by MISPL but not shown in the FAR of the MISPL.
- It held that once MCI admitted income in its tax return, on account of 100% attribution of profit to India, it meant that legally it had accepted carrying out those operations in India through PE and thus, now, the subsidiary company MISPL created PE of Applicant in India and the fact that MISPL was carrying on work of the Applicant, to that extent facility, service, personnel and premise of MISPL were at the disposal of the Applicant.

Creation of a PE through the Applicant's visiting employees?

- Noting that clients of the Applicant were in India, at the outset, relying on the SC ruling in *DIT vs. E-Funds IT Solution and Ors. (2017) 399 ITR 34 (SC), AAR* held that the first test for creating service PE was satisfied since service was provided to Indian customers.
- Further, while examining whether work carried by Applicant's employees visiting India (of understanding the future requirement, informing new products and to monitor the efficiency of the operation) was a part of the transaction processing service, it concluded that the same was an integral part of the Applicant's profession to provide new avenues of service to clients.
- Thus, it held that the employees of the Applicant visiting India were providing services to Indian clients and, once they crossed the threshold of 90 days in a year, a service PE was created.

MISPL – whether dependent agent PE?

- Referring to the process as to how agreements were concluded with the banks, AAR observed that the orders or agreements were routed through MISPL though the finalization of the contract was by the Applicant in Singapore, it would ultimately get accepted by the customer banks in India when MISPL brought that proposal or counter proposal to it.
- It held that the above position may not satisfy the requirement of "concluding contract" but it certainly satisfied the requirement of "securing order" under Article 5(8) of the DTAA and thus MISPL constituted a dependent agent PE under Article 5(8) of India-Singapore DTAA on account of habitually securing orders wholly for the Applicant.

(ii) While considering the question of whether the fees to be received by the Applicant constituted royalty or FTS as per Article 12 of the DTAA, AAR considered various aspects to the question and concluded as under:-

Whether fees to be received by the Applicant from Indian Customers, such as transaction processing fees, assessment fees and transaction related miscellaneous fees amounted to royalty?

- Referring to the MasterCard Licence Agreement between MCI (of which the applicant was a wholly owned indirect subsidiary) and the Indian customer banks (who paid fees to the Applicant), AAR opined that unlike in the case of *Formula One World Championship Ltd. v. CIT (2017) 394 ITR 80 (SC),* granting of license of trademarks/marks was the main purpose in present case. AAR observed that MCI had granted Licensee right to use various trademarks and marks owned by it solely in connection with License's payment card programmes which were programmes of Licensee (i.e. of Banks and FIs) and not of MasterCard.

- Further, perusing the licensing agreement between the Applicant and MCI US, who was the real owner of the Intellectual Property (IP), AAR noted that the Applicant was paying royalty to MCI for use of IP in various countries, including India. Thus, it concluded that such licensing agreement and payment of royalty for use of IPs in India further established that a part of the payment made by the customer banks in India to the Applicant was for use of these IPs.
- It concluded that licensing of various IPs in the form of brand/trade name/mark etc. were not incidental to the activity of transaction processing and the payment made by various customer banks in India to the Applicant was also for the use of these IPs and hence was royalty. Further, AAR clarified that since the payment was effectively connected with various types of PEs held aforesaid, it would get taxed with the PE under Article 7 and not under Article 12.

Whether the use of equipment (MIP) amounts to royalty?

- AAR held that the MIPs were equipment whose use constituted royalty and they were effectively connected with PE created on account of MIPs as well as other PEs.

Whether the use of secret process amounts to royalty?

- AAR held that the IP in MIPs and Master Card Network vest with the MCI which had licensed it to the Applicant. Further observing that these activities also use a secret process which was not in public domain, it held that the use of brand name, IP and secret process of Master Card by the Indian customers clearly fell under the definition of royalty, both under the Act as well as under the DTAA.

Whether the use of software amounts to royalty?

- AAR stated that the use of software inside MIP, and cards in the application software are an essential part of the transaction without which no transaction can be completed and thus the use of the software was subject to royalty and effectively connected to the PE.

Whether the fee payable to the Applicant amounts to FTS?

- Noting that ultimate beneficiary is the final consumer who is using the card, AAR ruled that the relation between final consumer and the Applicant was for use of a standard facility and hence, transaction processing service rendered by the Applicant could not be taxed under the Article concerning FTS in India-Singapore DTAA.
- For services other than transaction processing services [viz. in the nature of warning bulletin fees for listing invalid or fraudulent accounts either electronically or in paper form, cardholder service fees, program management services (e.g. Foreign exchange margin, commissions, load fees), account and transaction enhancement services, holograms and publication fees and advisory services etc.], it held that 'make available' condition (pre-requisite for qualifying as FTS under the DTAA) was not fulfilled and hence payment could not be classified as FTS.
- Thus, AAR held that the part of the fee paid to the Applicant, which was not royalty, was business income taxable under Article 7 and not under Article 12 of India Singapore DTAA. It was held that there was PE in India and the fee paid was taxable as business income arising through the PE

(iii) Further, it held that the Arm's length remuneration to PE on account of Indian Subsidiary for the activities performed / to be performed in India, would not absolve the Applicant from any further attribution of its

global profits in India since the FAR of the Indian Subsidiary did not reflect the functions/risks of the Applicant performed/undertaken by it.

(iv) Accordingly, tax at source was required to be withheld on amount attributed to the PE in India at the full applicable rate at which the non-resident was subjected to tax in India.

C. TRIBUNAL

7. Tax Residency Certificate – Section 90(4) r/w Sec. 90(2) of the Act – Whether the requirement of obtaining Tax Residency Certificate is mandatory to grant the benefits of the India-USA tax treaty to the non-resident assesses: Held No. In favour of the assessee

Skaps Industries India Pvt. Ltd. vs. ITO [TS-330-ITAT-2018(Ahd)] – Assessment years: 2013-14 and 2014-15

Facts

(i) The assessee made certain payments to a company resident of USA (US Co.) for installation and commissioning of an equipment in India.

(ii) No taxes were withheld on such payments by the assessee on the premise that the payments were not chargeable to tax in India as per the beneficial provision of the tax treaty.

(iii) The Income-tax officer (ITO) held that the services rendered by the US Co. were taxable as per the provisions of section 9(1)(vii) of the Income-tax Act, 1961 (the Act) and Article 12 of the India-USA tax treaty.

(iv) Since no taxes were withheld by the assessee, the payments made by the assessee was disallowed by the ITO in the assessment order of the assessee.

(v) Aggrieved by the ITO's order, the assessee appealed before the Commissioner of Income-tax (Appeals) [CIT(A)]. The CIT(A) upheld the disallowance made by the ITO as it observed that the US Co. had not furnished a valid TRC. Further, the CIT(A) held that the US Co. was not entitled to the beneficial provisions of the tax treaty.

Decision

(i) The Tribunal observed that as per the provisions of section 90(2) of the Act, the provisions of the Act shall apply only to the extent they are more beneficial to that the assessee and the same was often referred to as "treaty override".

(ii) The Tribunal also observed that the provisions of section 90(4) do not start with a *non-obstante* clause *vis-à-vis* section 90(2) of the Act. In the absence of such *non-obstante* clause, the Tribunal has held that section 90(4) cannot be construed as a limitation to the tax treaty superiority as stipulated in section 90(2) of the Act. Thereby the Tribunal has held that in the absence of a valid TRC, provisions of section 90(4) could not be invoked to deny tax treaty benefits.

(iii) Though the requirement to furnish TRC was not mandatory, the Tribunal has, nevertheless, emphasised that the US Co. had to establish that it was a USA tax resident. The onus was on the assessee to give sufficient and reasonable evidence to satisfy the requirements of Article 4(1) of the tax treaty, particularly when the same was called into question.

Note:

This decision affirms the position that the tax treaty benefits cannot be denied merely on the basis of non-availability of TRC. Further it also affirms that when a non-resident assessee has substantiated its residential status by way of sufficient and reasonable documentary evidence, the requirement of furnishing TRC would be persuasive and not mandatory.

8. India-Sweden DTAA 1997 – Application of MFN Clause r/w. Protocol to the DTAA – Taxability should be determined by reading tax treaty and its

protocol together – the protocol is not independent of the tax treaty

Ericsson Telephone Corporation India AB (India Branch TS-373-ITAT-2018(Del] – Assessment Year: 2000-01

Facts

(i) The assessee was incorporated in Sweden and was engaged in the field of telecommunication and mobile telephony. The assessee had a branch office in India.

(ii) The assessee, inter-alia, earned fees from Indian concerns being its associated enterprises for the supply of technical personnel engaged in installation and maintenance of mobile network system under contracts carried by such enterprises.

(iii) The assessee computed a net tax loss, after aggregating revenues from all the streams (including the above fees) and deducting common expenses therefrom.

(iv) During the assessment proceedings, the Income- tax officer (ITO) opined that the fee earned from Indian concerns was in the nature of fees for technical services (FTS), as per the India-Sweden tax treaty, and it should have been taxed on gross a basis without allowing any deduction of expenses.

(v) The ITO took note of an advance ruling obtained by the assessee in an earlier year, wherein it was held that fee received by the assessee was FTS in terms of the tax treaty and was taxable on a gross basis.

(vi) The Commissioner of Income-tax (Appeals) upheld the ITO's order. The aggrieved assessee filed an appeal before the Tribunal.

(vii) The advance ruling delivered in the assessee's own case considered provisions of the India-Sweden tax treaty as notified in March 1989. The new tax treaty was notified in December 1997 and governed the year under consideration.

(viii) The Protocol appended to the new tax treaty in June 1997 incorporated the Most Favoured Nation clause, whereby the "make available" clause, as provided in India-Finland tax treaty, had to be read into the India-Sweden tax treaty.

(ix) Although the advance ruling in the assessee's case attained finality, the taxability would have to be reconsidered in light of the protocol to the new tax treaty. The advance ruling would be binding, save and except a subsequent change in the relevant provisions of the Income-tax Act, 1961 or the tax treaty.

Decision

(i) A protocol to the tax treaty is to be considered as its part and parcel. A protocol completes the tax treaty. Therefore, the provisions of the protocol conferring, expanding or reducing a particular benefit, which is absent in the tax treaty, are to be applied to that extent.

(ii) The protocol should not be viewed as a document independent of the tax treaty and has to be considered as its addendum.

(iii) Considering that the tax treaty under which the advance ruling in the assessee's case was rendered has been substituted, the arguments of the assessee in the light of the new tax treaty would have to be considered.

(iv) As the TO passed the order simply on the basis of the advance ruling in the assessee's case for an earlier year, without considering the substituted tax treaty, the case was remanded back to the TO for deciding the issue afresh.

(Note: This decision reaffirms the position that a Protocol to the tax treaty has to be considered as its addendum, and if it extends or reduces a benefit absent in the tax treaty, the provisions of the Protocol will be applicable to that extent. The provisions of the Protocol to the tax treaty are to be followed in all situations, even if there is no dispute on the terms of the tax treaty.)

9. Rule 9 of the Income-tax (Dispute Resolution Panel) Rules, 2009 (DRP Rules) – Whether Additional Evidence

filed by the assessee before the DRP to be admitted and considered – Held Yes – in favour of the assessee

Bekaert Industries Pvt. Ltd. vs ACIT - ITA No.2376/PUN/2012 – Assessment Year : 2008-09

Facts

(i) The assessee, an Indian company, was engaged in the business of manufacture and sale of components in the automotive industry in India.

(ii) The assessee, *inter alia*, entered into an international transaction of import of raw material with its associated enterprise (AE) on a cost plus basis.

(iii) For benchmarking this transaction, the assessee chose the foreign AE, (being a contract manufacturer, supplying raw material on a cost plus basis) as the "tested party."

(iv) The Income-tax officer (ITO) did not accept the contentions of the assessee in this regard, alleging that there is no scope under the Indian transfer pricing (TP) regulations to consider the foreign AE as the tested party.

(v) The assessee once again before the DRP contended that as per the facts the foreign AE (being a contract manufacturer) was supplying raw material on a cost plus basis to the assessee (being an entrepreneur for the Indian market), therefore, the TP approach of the assessee should have been accepted.

(vi) To demonstrate the cost plus mark-up charged by the AE, the assessee filed certain additional evidence before the DRP.

(vii) After calling for a report from the TO on the evidence filed by the assessee, the DRP summarily rejected the additional evidence, citing the inadequacy of time (38 days before passing the DRP directions) for verification.

(viii) Aggrieved, the assessee filed an appeal before the Tribunal.

(ix) The assessee contended that :

(a) Section 144C(6) of the Income-tax Act, 1961 (the Act) *per se* provides that the DRP shall issue directions, *inter alia*, after considering records relating to the draft order [clause (e)] and evidence furnished by the assessee [clause (c)]. The natural corollary is clause (e) covers evidence filed before the TO and clause (c) covers additional evidence filed before the DRP, otherwise there was no reason to have clause (c) and (e) separately.

(b) Therefore, the DRP has to consider both, the evidence filed before the TO and the additional evidence filed before it while issuing its directions.

(c) There is a clear distinction between Rule 9 of the DRP Rules (which deals with the power of DRP to call for or permit additional evidence) and Rule 46A of the Income-tax Rules, 1962 (Rules) [which deal with the production of additional evidence before the Commissioner of Income-tax (Appeal)].

(d) Rule 46A begins with a negative covenant, i.e., the assessee has to substantiate why the additional evidence was filed before the CIT(A) and not before the TO. Whereas, Rule 9 of the DRP Rules has no such negative covenant; Rule 9 plainly permits the assessee to file additional evidence before the DRP.

(e) In any case, the DRP proceedings were an extension of assessment proceedings, and therefore, additional evidence should have been accepted and adjudicated.

(f) Once a report was called from the TO on the additional evidence filed before the DRP, the DRP should have admitted and adjudicated on the same.

Decision

(i) The Tribunal accepted the argument of the assessee and held that the additional evidence filed by the assessee was covered under sub-clause (c) of section 144C of the Act, i.e., "evidence

furnished by the assessee" as opposed to sub-clause (e), which covers "records relating to the draft order."

(ii) Therefore, it was held that in terms of section 144C(6) of the Act, the DRP should have issued directions after considering and commenting on the additional evidence filed before it.

(iii) The Tribunal also noted that the only requirement stated under the DRP rules vis-à-vis filing of additional evidence by the assessee was that it should not have formed a part of the paper book and it should have been filed separately as per Proviso to Rule 4 of the DRP Rules.

(iv) There was no other requirement under the DRP Rules. This is unlike Rule 46A of the Rules, which provides for certain conditions to be satisfied by the assessee for admission of additional evidence. Accordingly, in terms of Rule 9 of the DRP Rules, the DRP has the power to call for and even permit the additional evidence filed by the assessee.

(v) The Tribunal also noted that the DRP proceedings were a continuation of proceedings before the TO, and therefore, the DRP should have considered the additional evidence filed by the assessee in order to complete the assessment.

(vi) Finally, the Tribunal also accepted the contention of the assessee that once a remand report was called for from the TO, the additional evidence had to be considered.

(vii) On the aforesaid premises, the issue was remitted back to the DRP to consider and adjudicate upon the additional evidence.

10. India-Singapore DTAA – The Limitation of Relief provisions under Article 24 of the India-Singapore tax treaty do not apply to capital gains which is taxable in Singapore under Article 13(4) of the tax treaty

DCIT vs. D. B. International (Asia) Ltd [TS-321-ITAT-2018(Mum)] – Assessment Year: 2011-12

Facts

(i) During the Assessment Year (AY) 2011-12, the assessee, a tax resident of Singapore, derived capital gains on sale of shares, debt instruments, and derivatives of the Indian company. The assessee claimed that the capital gain was exempt under Article 13(4) of the tax treaty since it was liable to tax in Singapore on its worldwide income.

(ii) The Assessing Officer (AO) held that even though the provisions of Article 13(4) of the tax treaty allows exemption of capital gain in the source country i.e., India, the provisions of Article 24 of the tax treaty provides for restriction of such exemption in respect of capital gain to the extent of income repatriated to the country of residence i.e., Singapore. Referring to the provisions of the Singapore Income-tax Act, the AO observed that the income had to be taxed on receipt basis in Singapore even for the income received outside Singapore. Since the income from capital gain was not repatriated to Singapore in terms of Article 24 of the tax treaty, it had to be taxed in India under the Income-tax Act, 1961 (the Act) and exemption under Article 13(4) of the tax treaty cannot be allowed. Accordingly, the short-term capital gain was liable to tax in India.

(iii) The Dispute Resolution Panel (DRP) held that the entire income received by the assessee from all sources was taxable in Singapore irrespective of the fact whether it is received in Singapore or not. The capital gain derived from the sale of equities, debt securities and derivatives constitutes trade source income accruing in or derived from Singapore and was subject to tax in Singapore under the Singapore Income-tax Act. The assessee does not have a Permanent Establishment (PE) in India, and hence it was held that as per Article 13(4) of the tax treaty, Singapore had the exclusive right to tax the income and the restriction imposed under Article 24 of the tax treaty would not apply.

(iv) The DRP referred to the letter issued by the Inland Revenue Authority of Singapore (IRAS) confirming that the assessee was liable to tax in Singapore on its worldwide income.

(v) The DRP observed that once it was held that the capital gain was to be taxed in the country of residence of the assessee, the applicability of Article 24 becomes redundant since the income was taxable in Singapore with reference to the full amount and not with reference to the amount remitted to or received in Singapore. Accordingly, the DRP held that the capital gain derived by the assessee was not taxable in India under Article 13 of the tax treaty.

Decision

(i) On a perusal of Article 13 of the tax treaty, it was observed that the capital gain derived by the assessee from the sale of Indian securities would fall within the purview of Article 13(4) of the tax treaty. In the present case, the assessee was a resident of Singapore. Therefore, as per Article 13(4) of the tax treaty, the gain derived by the assessee from the sale of Indian securities could only be taxed in Singapore. The applicability of Article 24 of the tax treaty would not arise in the present case.

(ii) Article 24 of the tax treaty was applicable on fulfilment of two conditions – (i) income derived from the source state (i.e. India) is either exempt from tax or taxed at a reduced rate in the source state; and (ii) the amount remitted/received out of such income in the resident State (i.e. Singapore), was taxable to the extent of such remittance/ receipts. If both the conditions are satisfied, then the exemption is allowed or the reduced rate of tax is levied on the amount so remitted.

(iii) The first condition which Article 24 of the tax treaty provides that the income derived from a source state should either be exempt from tax or taxed at a reduced rate in that state. Article 13(4) of the tax treaty does not state that the capital gain derived in a source state is exempt from taxation in that state. Article 13(4) of the tax treaty states that capital gain derived by a resident of a contracting state shall be taxable only in that state.

(iv) Thus, Article 13(4) of the tax treaty is clear and unambiguous, and it states the taxability of particular income in a particular state by virtue of residence of the assessee. The provisions of Article 24 of the tax treaty do not have much relevance insofar as it relates to the applicability of Article 13(4) of the tax treaty to income derived from capital gains.

(v) The expression 'exempt' with reference to the capital gains derived by the assessee was loosely used. On the contrary, the overriding nature of Article 13(4) of the tax treaty makes the capital gains taxable only in the country of residence of the assessee. Accordingly, it was held that the capital gains derived by the assessee was not taxable in India under Article 13(4) of the tax treaty.

(Remarks: It is important to note that the tax treaty has been amended with effect from 1st April 2017. However, this decision deals with the tax treaty as it stood prior to the amendment. Under the revised tax treaty, India has a right to tax capital gains arising on sale of shares of Indian companies acquired on or after 1st April 2017. However, the principles emerging from this decision are still relevant as under the amended tax treaty, capital gains on the sale of (a) instruments other than shares; and (b) shares acquired before 1st April 2017 continue to remain outside the purview of Indian taxation. Further, under the amended tax treaty, capital gains on the sale of shares acquired and disposed between 1st April 2017 and 31st March 2019 (transition period) are taxable in India at 50 per cent of the tax rate applicable under the Act. Thus, based on this decision, Article 24 would only apply to capital gains which are taxable in India at a 'reduced rate' during the transition period provided such gains are taxable in Singapore on a remittance basis.)

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CA Sheel Bhanushali

INDIRECT TAXES
GST Gyan

ISSUES IN JOB WORK UNDER GST

Business and its innovation change constantly. However law is not able to keep pace with them. The situation and context in which the law was made, often undergo changes. This poses a practical challenge of applying the enacted law to the new scenarios which keep emerging with the progress of business practices. However whenever a new law comes in place it puts some stress on the existing way of doing business and this leads to issues which have to be addressed carefully. The Goods and Services Tax Act of 2017 (GST) since its enactment has impacted the businesses in almost all aspects due to which the businessman and other stakeholders are grappling to streamline their affairs in sync with the law in all its true spirit.

This article covers one such area where considerable impact of GST is experienced is that of the activity of job work. This activity is a very important element of any business which has to undertake many activities before the final product can emerge. Commercially job work is an outsourced activity which gives the principal the benefit of specialisation and reduced cost simultaneously. The practical issues in GST concerning job work are taken up with probable solutions in the light of the existing legal scenario.

Section 2(68) The Central Goods and Services Tax Act, 2017 (CGST Act) defines" **"job work"** *means any treatment or process undertaken by a person on goods belonging to another registered person and the expression "job worker" shall be construed accordingly.*

Consequently a question arises that what if job work is done for unregistered principal. On the plain reading of the definition it necessitates that to be a job work the principal should be a registered person. So in a case where job work is done on goods belonging to an unregistered principal, it will not be considered as job work seems to be the impact. Therefore, in a case where the principal is not a registered person, the activity will not qualify as job work and should be classified as residual category of service which would be in line with Schedule II Entry No. 3 which reads as *"Any treatment or process which is applied to another person's goods is a supply of services."* This may attract higher rate of tax.

In the erstwhile excise law, the job worker was liable to pay excise duty if after performing the treatment or process on the principal's inputs there emerged an independent product having its own distinct name, character and use. Such goods

were referred to as a commercially independent product. The focus of excise law was, in whose hands the conversion took place rather than who was the owner of those goods. Whether the same understanding continues in the GST regime or is there a paradigm shift because in GST the basis of charge is on 'Supply' of goods and/or services. This question becomes important because if the result of job work is a distinct product then on its return back to the principal the authorities may consider it as a separate supply from the job worker to the principal and all consequences of the act will be applicable. The benefit of job work provisions under section 143 of CGST Act will then not be available. Thus emergence of a commercially independent product in the hands of the job worker should still be considered as job work or manufacture?

Section 2(68) of The CGST ACT defines" **"job work"** *means any treatment or process undertaken by a person on goods belonging to another registered person and the expression "job worker" shall be construed accordingly;*

Section 2(72) of the CGST Act defines **"manufacture"** *means processing of raw material or inputs in any manner that results in emergence of a new product having a distinct name, character and use and the term "manufacturer" shall be construed accordingly.*

The definition of job worker envisages treatment or process to be done on goods which belong to other person. Whereas there is no such requirement of goods belonging to others in the definition of manufacture. Perhaps the words *'processing of raw materials and inputs"* in the definition of manufacture gives an impression that if job work results in emergence of a new product having a distinct name, character and use, it would constitute manufacture.

The main reason why a job worker is hired is due to his ability and experience in performing the treatment or process. He has no ownership over the principal's goods whether before or even after the processing is done. Whatever emerges solely belongs to the principal. Further the definition of manufacture says processing of raw materials and inputs done *"in any manner…..and the term manufacturer shall be construed accordingly".* The words in any manner explains that the principal may do the processing himself or get it done from any other person and accordingly in both the situations he would be considered as the manufacturer.

Thus manufacture should be considered from the owner's point of view. If job work results in a distinct new product it should not be considered as manufacture in the hands of job worker.

Here it is important to refer to the advance ruling in the case of JSW Energy Ltd. AAR Maharashtra dated 5th March, 2018 wherein it was ruled otherwise. The authority ruled that if after treatment and processing if there is emergence of a new product having distinct name, character and use, it would be treated as manufacture and not job work in the hands of the job worker. The reasoning given was that, *"as can be seen the definition of manufacture itself says that the emergence of a new product from the processing of the inputs would be a manufactured product. In the instant case the end product i.e., "electricity" has a distinct name, character and use than the inputs i.e., "coal". Thus, when the Legislature has provided for the definition of 'job work' as well as 'manufacture', the meaning as understood by the definition of 'manufacture' cannot be read into the words 'treatment or process' as found in the definition of 'job work'. 'Treatment', 'Process' and 'Manufacture' are three different activities recognised by the Legislature. The intent of the Legislature is to restrict the scope of 'job work' to 'treatment' or 'process' and not to extend the same to 'manufacture'. We need not deliberate more on the issue as the emergence of a distinct commodity is very obvious and therefore beyond the applicability of the definition of 'job work' under the GST Act."*

The assessee further appealed the matter to the Appellate Authority of Advance Ruling (AAAR) and sought the relief that processing of goods belonging to another person qualifies as job work even if it amounts to manufacture. The AAAR ordered the JSW's activity *per se* did not qualify for as job work and would amount to manufacture

because the goods supplied by the principal were consumed in the process and did not maintain its substantial form i.e., coal supplied got fully consumed in producing electricity. However the order of the Advance Ruling Authority was modified to the extent that recognition was given to the fact that *"The processing undertaken by a person on the goods belonging to another registered person qualifies as job work even if it amounts to manufacture provided all the requirements under the CGST/MGST Act in this behalf, are met."* Para 59 of the order.

However for practical implementation one will have to take a position based on the facts of each case. This aspect is also mentioned in *Para 5 of Circular 38/12/2018, dated 26-3-2018* that the job worker is expected to work on the goods sent by the principal and whether the activity is covered within the scope of job work or not would have to be determined on the basis of facts and circumstances of each case.

Moving further to the activity of packing, re-packing, testing & inspection, labelling and the like will these be treated as 'treatment or process' for job work purpose. The words treatment and process are not defined in the CGST Act. The eligibility of the process to be job work one may refer to *M/s. Prestige Engineering (India) vs. Collector of C. Ex. Meerut 1994 (73) ELT 497 (SC)* wherein various examples of job work involved in different civil appeals have been discussed. Thus in the commercial sense the meaning would cover any activity which achieves the desired improvement. It may result in improvement in utility, appearance, movability, marketability and the like. Ascertaining these whether being job work would be depend upon the facts of every case as reiterated in the circular as mentioned supra.

There may be a situation where due to some dispute between principal and job worker, instead of returning the goods they are retained with him as consideration for his job work charges. These are sold in the open market and thereby consideration recovered. What would be the taxable value in this situation. Whether it would be the transaction value as agreed upon or will it be the open market value or the price at which the principal would have sold it. The Hon'ble Supreme Court in the case of *Pawan Biscuits & Co. 2000 (120) ELT (24)* under the earlier laws had decided that the valuation for the same goods should be considered transaction value by the job worker and not at any other value. The same should hold good in the GST regime too.

If the principal is not able to bring back the inputs sent to a job worker within the prescribed time limit of one year then as per section 19(3) it would be treated as deemed supply by the principal to the job worker. The date of sending the goods to the job worker would be considered as the date of supply. The principal has to issue invoice and declare such supplies in his return for that particular month in which the time period of one year has expired.

The question then arises is that whether the job worker is eligible to avail credit of the GST paid by the principal by considering the same as deemed supply.

As per section 16(4) *"A registered person shall not be entitled to take input tax credit in respect of any invoice or debit note for supply of goods or services or both after the due date of furnishing of the return under section 39 for the month of September following the end of financial year to which such invoice or invoice relating to such debit note pertains or furnishing of the relevant annual return, whichever is earlier".*

In this situation it is pertinent to note that though the date of supply shall be the date on which such inputs were initially sent to the job worker, the date of invoice will be that of the current period. This will enable the job worker is to avail the credit of the same.

Moreover, second proviso to section 16(2) of the CGST Act, 2017 prescribes that to avail the credit the job worker has to pay the said amount to the principal. The same may be done by way of making payment in cash or returning the said goods as supply of job worker. For the same job worker has to raise his own tax invoice stating principal as buyer.

Another situation where goods cannot be brought back by the principal is when goods sent

to job worker are lost/destroyed due to some unavoidable circumstances. Two scenarios crop up for consideration. First, should this be treated as deemed supply by the principal as envisaged under section 19(3). Second, is the principal required to reverse credit under section 17(5)(h).

Deemed supply would get triggered when the goods are identifiable and in existence but not returned to the principal within the prescribed time limit of one year. In the instant case since goods are lost/destroyed the principal will face the credit being blocked under section 17(5)(h). Input tax credit reversal would be the most appropriate treatment.

A registration issue may arise when the job worker provides his services inter-state. Section 24(i) CGST Act, 2017, requires compulsory registration for making inter-state taxable supply irrespective of threshold limit. Will this necessitate compulsory registration for the job worker. This was the difficulty faced by small and medium job workers who were doing business below the threshold limit. This position has been clarified *vide* Notification No. 10/2017 – Integrated Tax dated October 13, 2017. Accordingly job worker is required to obtain registration only in cases where his aggregate turnover, to be computed on all India basis, in a financial year exceeds the threshold limit. This is regardless of whether the principal and the job worker are located in the same State or in different States. Thus exemption from mandatory registration was granted in case of supply of job work services.

Job worker would raise an invoice for supply of services on the principal. However when the goods are being sent back by the job worker a situation arises in preparing the e-way Bill. The issue is regarding the consignment value to be declared. Should the consignment value in e-way Bill be only that of the goods being sent back or should it be the sum total of the value of goods and the value of services of the job worker.

Explanation 2 Rule 138(1) of the CGST Rule 2017 relating to e-way bill prescribes that *"For the purposes of this rule, the consignment value of goods shall be the value, determined in accordance with the provisions of section 15, declared in an invoice, a bill of supply or a delivery challan, as the case may be, issued in respect of the said consignment and also includes the Central tax, State or Union territory tax, integrated tax and cess charged, if any, in the document and shall exclude the value of exempt supply of goods where the invoice is issued in respect of both exempt and taxable supply of goods."*

The e-way bill discipline ensures that the movement of goods above the prescribed value is documented so that its trail is established. E-way bill requires the consignment value to be the transaction value to be declared in the e-way bill. The transaction value between the job worker and the principal is the job work charges for the supply of services. These charges definitely add value to the goods and will be considered even by the principal in his costing and pricing decisions. Moreover while sending the goods back, the job worker will have to prepare the delivery challan which will contain the value of the goods as it was mentioned by the principal when the goods were originally sent for job work. In addition the invoice of the job worker will also accompany the goods during its movement. Thus there would be two documents declaring different values. The basic fact remains that job work intrinsically adds to the utility of the goods. Consequently on a combined analysis it is prudent to include the value of the job work charges in the consignment value.

Conclusion

GST law for the job work industry is reasonably well laid and the issues arising in it are also being addressed by the Government as far as possible. However, as the industry progress intricacies will keep surfacing every now and then, one has to be proactive in identifying and taking a position remaining within the prescribed law.

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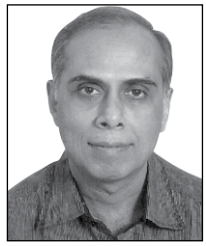


CA Rajkamal Shah & CA Bharat Vasani

INDIRECT TAXES
GST – Legal Update

NOTIFICATIONS

7th Amendment to CGST Rules *(CGST Notification No. 29/2018 dt. 6-7-2018)*
Anti-profiteering Rules 125, 129, 130, 131, 132, 133 amended to substitute "Director General of Safeguards" with "Director General of Anti-profiteering". *(These amendments are deemed to be effective from 12-6-2018)*

Due date for filing of GSTR 6 extended *(CGST Notification No. 30/2018 dt. 30-7-2018)*
Due date for filing of GSTR 6 by Input Service Distributor for the period July 2017 to August'18 extended upto September, 2018.

Rates of CGST on Services amended *(CGST Rate Notification No. 13/2018 dt. 26-7-2018)*
(These amendments are effective from 27-7-2018)

Amendments to Entry 7: Accommodation, food and beverage services
Item (i) provides for CGST @ 2.5% for Restaurant Service. Explanation inserted so as to include supply at a canteen, mess, cafeteria or dining space of an institution such as a school, college, hospital, industrial unit, office, by such institution or by any other person based on a contractual arrangement with such institution for such supply, provided that such supply is not event based or occasional. Another explanation inserted to specifically exclude services covered under item (v) from item (i).

Accordingly Circular No. 28-2-2018 dt. 8-1-2018 as amended *vide* Corrigendum dt. 18-1-2018 is withdrawn *vide* Circular No. 50/24/2018 dt. 31-7-2018.

Item (v) providing for CGST rate supply by way of outdoor catering services substituted for supply at Exhibition Halls, Events, Conferences, Marriage Halls and other outdoor or indoor functions that are event based or occasional in nature.

Item (ia) inserted in Entry 7 to provide CGST @ 2.5% for supply of food or any other article for human consumption or any drink by Indian Railways or Indian Railways Catering and Tourism Corporation Ltd or their licensees, whether in train or at platforms.

Accordingly, Order No. 02/2018 dt. 31-3-2018 is withdrawn *vide* Circular No. 50/24/2018 dt. 31-7-2018.

Items (ii), (vi) and (viii) providing rates for accommodation in hotels, inns, guest houses, clubs, campsites or other commercial places

meant for residential or lodging purposes amended to substitute the words "declared tariff" for the words "value of supply". Also, the explanation to these items is deleted.

Amendments to Entry 9: Goods transport services
Item (vi) being residual entry substituted with new entry providing CGST rate @ 12% for Mutimodal Transportation of Goods.

Explanation –

(a) "multimodal transportation" means carriage of goods, by at least two different modes of transport from the place of acceptance of goods to the place of delivery of goods by a multimodal transporter;

(b) "mode of transport" means carriage of goods by road, air, rail, inland waterways or sea;

(c) "multimodal transporter" means a person who,-

(A) enters into a contract under which he undertakes to perform multimodal transportation against freight; and

(B) acts as principal, and not as an agent either of the consignor, or consignee or of the carrier participating in the multimodal transportation and who assumes responsibility for the performance of the said contract.

Item (vii) inserted as a residual entry to provide for CGST @ 18%.

Amendments to Entry 22: Telecommunications, Broadcasting and Information Supply services
Item inserted to provide CGST @ 2.5% for supply consisting of only e-book.

Exempt Services amended *(CGST Rate Notification No. 14/2018 dt. 26-7-2018)*

(These amendments are effective from 27-7-2018)

Entry no. 4 and 5 exempting services provided in relation to any function entrusted to a municipality under Article 243W and panchayat under Article 243G of the Constitution amended to omit the service provider being Central Government, State Government, Union Territory, Local Authority. Thus, now only services provided by Governmental Authority are exempt.

Entry 9D inserted to exempt Services provided by an old age home run by Central Government, State Government or by an entity registered u/s. 12AA of Income-tax Act, 1961 to its residents being above 60 years of age against consideration upto ₹ 25,000 per month per member provided that the consideration charged is inclusive of charges for boarding, lodging and maintenance.

Entry 10A inserted to exempt Services supplied by electricity distribution utilities by way of construction, erection, commissioning, or installation of infrastructure for extending electricity distribution network upto the tube well of the farmer or agriculturalist for agricultural use.

Entry 14 exempting services by way of accommodation in hotels, inns, guest houses, clubs, campsites or other commercial places meant for residential or lodging purposes amended to substitute the words "declared tariff" for the words "value of supply" below ₹ 1,000 per day.

Entries 19A & 19B: Exemption to transportation of goods by an aircraft or vessel from customs station of clearance in India to a place outside India extended up to 30-09-2019.

Entry 24A inserted to exempt Services by way of warehousing of minor forest produce.

Entry 31A inserted to exempt Services by Coal Mines Provident Fund Organisation to persons governed by the Coal Mines Provident Fund and Miscellaneous Provisions Act, 1948.

Entry 31B inserted to exempt Services by National Pension System (NPS) Trust to its members against consideration in the form of administrative fee.

Entry 34A inserted to exempt Services supplied by Central Government, State Government, Union territory to their undertakings or Public Sector Undertakings (PSUs) by way of guaranteeing the loans taken by such undertakings or PSUs from the financial institutions.

Entry 36A amended to additionally exempt re-insurance services of the schemes specified in entry 40 i.e., Services provided to the Central Government, State Government, Union territory under any insurance scheme for which total premium is paid by the Central Government, State Government, Union territory.

Entry 47A inserted to exempt Services by way of licensing, registration and analysis or testing of food samples supplied by the Food Safety and Standards Authority of India (FSSAI) to Food Business Operators.

Entry 55A inserted to exempt Services by way of artificial insemination of livestock (other than horses).

Entry 65B inserted to exempt Services supplied by a State Government to Excess Royalty Collection Contractor (ERCC) by way of assigning the right to collect royalty on behalf of the State Government on the mineral dispatched by the mining lease holders.

Explanation – "Mining lease holder" means a person who has been granted mining lease, quarry lease or licence or other mineral concession under the Mines and Minerals (Development and Regulation) Act, 1957 (67 of 1957), the rules made thereunder or the rules made by a State Government under sub-section (1) of section 15 of the Mines and Minerals (Development and Regulation) Act, 1957.

Provided that at the end of the contract period, ERCC shall submit an account to the State Government and certify that the amount of goods and services tax deposited by mining lease holders on royalty is more than the goods and services tax exempted on the service provided by State Government to the ERCC of assignment of right to collect royalty and where such amount of goods and services tax paid by mining lease holders is less than the amount of goods and services tax exempted, the exemption shall be restricted to such amount as is equal to the amount of goods and services tax paid by the mining lease holders and the ERCC shall pay the difference between goods and services tax exempted on the service provided by State Government to the ERCC of assignment of right to collect royalty and goods and services tax paid by the mining lease holders on royalty.

Entry 77A inserted to exempt Services provided by an unincorporated body or a non-profit entity registered under any law for the time being in force, engaged in, –

(i) activities relating to the welfare of industrial or agricultural labour or farmers; or

(ii) promotion of trade, commerce, industry, agriculture, art, science, literature, culture, sports, education, social welfare, charitable activities and protection of environment, to its own members against consideration in the form of membership fee upto an amount of one thousand rupees (₹ 1,000/-) per member per year.

Explanation (iv) to notification added to clarify that Central and State Educational Boards shall be treated as educational institution for the limited purpose of providing services by way of conduct of examination to the students.

Exempt Services amended *(IGST Rate Notification No. 15/2018 dt. 26-7-2018)*

Entry 10F inserted to exempt services supplied by establishment of a person in India to any establishment of that person outside India, which are treated as establishments of distinct

persons provided the place of supply is outside India.

Entry 10G inserted to exempt import of services by UN or a specified international organisation for official use of the UN or a specified international organisation.

Entry 10H inserted to exempt import of services by foreign diplomatic mission or consular post in India, or diplomatic agents or career consular officers posted therein. Exemption is subject to certain conditions mentioned in the notification.

Other amendments are in line with notification issued under CGST.

Amendment to Services covered under RCM *(CGST Rate Notification No. 15/2018 dt. 26-7-2018)*
(These amendments are effective from 27-7-2018)

Entry 11 inserted to cover the Services provided by individual Direct Selling Agents (DSA's) other than a body corporate, partnership or LLP firm to a banking company or a NBFC located in the taxable territory.

Clause (g) inserted under *explanation* to the notification to provide that "renting of immovable property" means allowing, permitting or granting access, entry, occupation, use or any such facility, wholly or partly, in an immovable property, with or without the transfer of possession or control of the said immovable property and includes letting, leasing, licensing or other similar arrangements in respect of immovable property.

Amendment to list of supplies treated neither as supply of goods nor services *(CGST Rate Notification No. 16/2018 dt. 26-7-2018)*
(These amendments are effective from 27-7-2018)

Notification No. 14/2017 amended to include services provided by Union Territory also. Services in relation to a function entrusted to a Municipality under Article 243W of the Constitution.

CGST on Services amended *(CGST Rate Notification No. 17/2018 dt. 26-7-2018)*
(These amendments are effective from 27-7-2018)

Entry 3(vi) provides for CGST @ 6% on Composite Supply of works contract to Government in relation to a civil structure predominantly for use other than business.

Explanation inserted to provide that "business" shall not include any activity or transaction undertaken by the Central Govt., State Govt. or any local authority in which they are engaged as public authorities.

Amendment to CGST Rates for Goods *(CGST Rate Notification No. 18/2018 dt. 26-7-2018)*
(These amendments are effective from 27-7-2018)

A] GST Rates are amended as under:

Entry No.	HSN Code	Items	New Rate	Old Rate
Schedule I				
102A	2207	Ethyl alcohol supplied to Oil Marketing Companies for blending with motor spirit (petrol)	2.5%	9%
170A	2809	Fertilizer grade phosphoric acid	2.5%	9%
Schedule II				
96A	4409	Bamboo Flooring	6%	9%

Entry No.	HSN Code	Items	New Rate	Old Rate
185A	7419 99 30	Brass Kerosene Pressure Stove	6%	9%
206A	87	Fuel Cell Motor Vehicles	6%	9%/ 14%
231B	9607	Slide Fasteners	6%	9%
		Schedule III		
52A	3208	Paints and varnishes (including enamels and lacquers) based on synthetic polymers or chemically modified natural polymers, dispersed or dissolved in a non-aqueous medium; solutions as defined in Note 4 to this Chapter	9%	14%
52B	3209	Paints and varnishes (including enamels and lacquers) based on synthetic polymers or chemically modified natural polymers, dispersed or dissolved in an aqueous medium	9%	14%
52C	3210	Other paints and varnishes (including enamels, lacquers and distempers); prepared water pigments of a kind used for finishing leather	9%	14%
54B	3214	Glaziers' putty, grafting putty, resin cements, caulking compounds and other mastics; painters' fillings; non-refractory surfacing preparations for facades, indoor walls, floors, ceilings or the like	9%	14%
319A	8418	Refrigerators, freezers and other refrigerating or freezing equipment, electric or other; heat pumps other than air conditioning machines of heading 8415	9%	14%
341A	8450	Household or laundry-type washing machines, including machines which both wash and dry	9%	14%
376AA	8507 60 00	Lithium-ion batteries	9%	14%
376AB	8508	Vacuum cleaners	9%	14%
376AC	8509	Electro-mechanical domestic appliances, with self-contained electric motor, other than vacuum cleaners of heading 8508 [other than wet grinder consisting of stone as a grinder]	9%	14%
376AD	8510	Shavers, hair clippers and hair-removing appliances, with self-contained electric motor	9%	14%
378A	8516	Electric instantaneous or storage water heaters and immersion heaters; electric space heating apparatus and soil heating apparatus; electro thermic hair-dressing apparatus (for example, hair dryers, hair curlers, curling tong heaters) and hand dryers; electric smoothing irons; other electro-thermic appliances of a kind used for domestic purposes; electric heating resistors, other than those of heading 8545	9%	14%

Entry No.	HSN Code	Items	New Rate	Old Rate
383C	8528	Television set (including LCD or LED television) of screen size not exceeding 68 cm	9%	14%
401A	8705	Special purpose motor vehicles, other than those principally designed for the transport of persons or goods (for example, breakdown lorries, crane lorries, fire fighting vehicles, concrete-mixer lorries, road sweeper lorries, spraying lorries, mobile workshops, mobile radiological unit)	9%	14%
402A	8709	Works trucks, self-propelled, not fitted with lifting or handling equipment, of the type used in factories, warehouses, dock areas or airports for short distance transport of goods; tractors of the type used on railway station platforms; parts of the foregoing vehicles	9%	14%
403A	8716	Trailers and semi-trailers; other vehicles, not mechanically propelled; parts thereof [other than Self-loading or self-unloading trailers for agricultural purposes, and Hand propelled vehicles (e.g. hand carts, rickshaws and the like); animal drawn vehicles]	9%	14%
449AA	9616	Scent sprays and similar toilet sprays, and mounts and heads therefor; powder-puffs and pads for the application of cosmetics or toilet preparations	9%	14%

B] Following are the amendments in the description of items:

Entry No.	HSN Code	Amendments
	Schedule I	
123	2515 (Except 2515 12 10, 2515 12 20, 2515 12 90) or 6802	Words "other than mirror polished stone which is ready to use" inserted
215	5305 to 5308	Words "including coir pith compost put up in unit container and bearing a brand name" inserted
219	5702, 5703, 5705	Handloom durries included
222	61 or 6501 or 6505	Cap / Topi included
225	64	Footwear not exceeding ₹ 1000 substituted for ₹ 500
264	Any chapter	Solid bio-fuel pellets included
	Schedule II	
146	5705	Words "except the items covered in 219 in Schedule I" inserted at the end
147	5801	Entry omitted
195A	8420	Entry substituted for Hand Operated Rubber Roller

Entry No.	HSN Code	Amendments
195AA	8424	Nozzles for drip irrigation equipment or nozzles for sprinklers
235	9619 00 30, 9619 00 40, or 9619 00 90	Entry substituted for "All goods" under HSN mentioned hereunder
	Schedule III	
25	2207	Brackets and words "[other than ethyl alcohol supplied to Oil Marketing Companies for blending with motor spirit (petrol)]" inserted at the end
137	4409	Brackets and words "[other than bamboo flooring]" inserted at the end
177E	6802	Words "except the items covered in Sl. No. 123 in Schedule I", shall be inserted at the end
253	7419	Brackets and words "[other than Brass Kerosene Pressure Stove]" inserted at the end
321	8420	Brackets and words "[other than Hand operated rubber roller]" inserted at the end
446	9607	Entry substituted for "Parts of slide fasteners"
139	8507	Words "other than Lithium-ion battery" inserted
154	8528	Words "[other than Television set (including LCD and LED television) of screen size not exceeding 68 cm]" inserted

Amendment to rates of Compensation Cess ***(Compensation Cess Rate Notification No. 02/2018 dt. 26-7-2018)***
(These amendments are effective from 27-07-2018)

Following entries inserted:

Entry No.	HSN Code	Items	Rate
41A	27	Coal rejects supplied by a coal washery, arising out of coal on which compensation cess has been paid and no input tax credit thereof has not been availed by any person	NIL
42B	87	Fuel Cell Motor Vehicle	NIL

Amendment to list of Exempt Goods ***(CGST Rate Notification No. 19/2018 dt. 26-07-2018)***
(These amendments are effective from 27-7-2018)

A] GST Rates are amended as under:

Entry No.	HSN Code	Items
92A	1401	Sal leaves, siali leaves, sisal leaves, sabai grass

Entry No.	HSN Code	Items
93B	1404 90 90	Vegetable materials, for manufacture of jhadoo or broom sticks
114A	44 or 68	Deities made of stone, marble or wood
114B	46	Khali Dona; Goods made of sal leaves, siali leaves, sisal leaves, sabai grass, including sabai grass rope
132A	53	Coir pith compost other than those put up in unit container and, (a) Bearing a registered brand name; or (b) Bearing a brand name on which an actionable claim or enforceable right in a court of law is available [other than those where any actionable claim or enforceable right in respect of such brand name has been foregone voluntarily, subject to the conditions as in the ANNEXURE I]
146A	9619 00 10 or 9619 00 20	Sanitary towels (pads) or sanitary napkins; tampons
152	Any chapter except 71	Rakhi (other than those made of goods falling under Chapter 71)

B] Following are the amendments in the description of entries:

Entry No.	HSN Code	Amendments
102A	2306	Explanation: The exemption applies to de-oiled rice bran falling under heading 2306 with effect from 25th January, 2018
117	48 or 4907 or 71	Entry substituted for "Rupee notes or coins when sold to Reserve Bank of India or the Government of India"

Amendment to Notification No. 05/2017 ***(CGST Rate Notification No. 20/2018 dt. 26-7-2018)***
Original Notification No. 5/2017 denies refund of unutilised input tax credit for certain items having inverted duty structure. Now a Proviso is added to allow such refund in case of items such as woven fabrics of silk, wool, cotton, various fibres, knitted or crocheted fabrics etc for ITC accumulated on supplies received on or after the 1st day of August, 2018.

However, accumulated unutilised ITC lying in balance, after payment of tax for and up to the month of July, 2018, on the inward supplies received up to the 31st day of July 2018, shall lapse.

Concessional rate on specified handicraft items ***(CGST Rate Notification No. 21/2018 dt. 26-7-2018)***
A list of 39 handicraft items are notified which will attract 1.5%, 2.5% or 6% CGST respectively. Also

Explanation is added to define Handicraft Goods to mean goods predominantly made by hand even though some tools or machinery may also have been used in the process.

Notifications No. 14/2018 to Notification No. 22/2018 under IGST (Rate) are in line with notifications issued under CGST (Rate).

GST on Ambulance Service provided to State Government by Private Service Provider (PSP's) (Circular No. 51/25/2018 dt. 31-7-2018)

Transportation of patients on behalf of State Government provided by PSPs to State Government for fee or other consideration, where supply is a Pure Service or Composite supply consisting of supply of goods not more than 25% is exempt *vide* Entry 3 and 3A of Notification No. 12/2017 – CT (Rate) dated 28-6-2018.

PRESS RELEASE

Recommendations made in the 28th meeting of the GST Council held on 21-7-2018

i. Upper limit for Composition Scheme to be raised to ₹ 1.5 crore from ₹ 1 crore

ii. Composition dealers to be allowed to supply service not exceeding 10% of turnover in preceding F.Y. or ₹ 5 lakh whichever is higher

iii. GST under RCM on receipt of supplies from URP to be applicable to only specified goods in case of notified classes of registered persons

iv. The threshold exemption limit in the State of Assam, Arunachal Pradesh, Himachal Pradesh, Meghalaya, Sikkim and Uttarakhand to be increased to ₹ 20 lakh

v. Tax-payers may opt for multiple registrations within State/Union Territory in respect of multiple place of business located within State/Union Territory

vi. Mandatory registration is required for only those e-commerce operators who are required to collect tax at source

vii. Registration to remain temporarily suspended while cancellation of registration is under process, so that the taxpayer is relieved of continued compliance under the law

viii. Following transactions to be treated as no supply under Schedule III:

   a. Supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India

   b. Supply of warehoused goods to any person before clearance for home consumption and

   c. Supply of goods in case of high sea sales

ix. Scope of input tax credit is being widened, and it would now be made available in respect of the following:

   a. Most of the activities or transactions specified in Schedule III

   b. Motor vehicles for transportation of persons having seating capacity of more than thirteen (including driver), vessels and aircraft

   c. Motor vehicles for transportation of money for or by a banking company or financial institution

   d. Services of general insurance, repair and maintenance in respect of motor vehicles, vessels and aircraft on which credit is available and

   e. Goods or services which are obligatory for an employer to provide to its employees, under any law for the time being in force

x. In case recipient fails to pay the due amount to supplier within 180 days from the date of issue of invoice, the input tax credit availed by recipient will be reversed, however interest on the same is done away with

xi. Registered person may issue consolidated Debit / Credit note in respect of multiple invoices in a Financial Year

xii. Amount of pre-deposit payable for filing of appeal before the appellate authority and the appellate tribunal to be capped at ₹ 25 crore and ₹ 50 crore respectively

xiii. Commissioner to be empowered to extend the time limit for return of inputs and capital sent on job work, up to a period of one year and two years, respectively

xiv. Supply of service to qualify as exports, even if payment received in Indian Rupees, where permitted by RBI

xv. Place of supply to be outside India, in case of job work of any treatment or process done on goods temporarily imported into India and then exported without putting them to any other use in India

xvi. Recovery can be made from distinct persons, even if present in different State/ Union territories

xvii. The order of cross-utilisation of input tax credit is being rationalized

Above-mentioned amendments to be placed before the Parliament and legislatures of State and Union Territories to carry out amendments in respective Acts.

Recommendation on Opening of Migration Window dt. 21-07-2018

i. This window will be opened for taxpayers who received Provisional ID's but could not complete the migration process

ii. The taxpayers who filled in Part A of FORM GST REG 26 but not Part B are requested to approach the Jurisdictional nodal officer on or before 31-8-2018

iii. The nodal officer would then forward details to GSTN to enable migration

iv. Also, late fees would be waived in such cases. However, first late fees will have to be paid and later waiver will be effected by way of credit of amount paid in cash ledger.

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CA Naresh Sheth & CA Piyush Jain

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Writs, Special Leave Petitions and other grievances

1. Berger Paints India Limited vs. State of Kerala & Ors. (2018-TIOL-84-HC-KERALA-GST)

Facts, Issue involved and Contention of Petitioner

Petitioner is engaged in manufacturing and dealing in paints. Petitioner's machinery was seized by the authorities. Petitioner got the machinery and transport vehicle released by submitting bank guarantee as well as security bond.

Petitioner was faced with adverse orders and contemplated invoking appellate remedy. However, the authorities threatened to invoke the bank guarantee before petitioner could invoke the appellate remedy. According to petitioner's counsel, appellate forum itself was very recently created and procedural modalities have yet to be finalised. In meanwhile, if the respondents invoke the bank guarantee, petitioner's right to statutory remedies becomes illusory. Hence, writ petition has been filed.

Held

In terms of Section 107 of the CGST Act, read with Rule 108 of the CGST Rules, petitioner has three months' time from date of impugned order to file an appeal. Because petitioner has three months' time to appeal, it may be inequitable for authority to invoke bank guarantee before petitioner could exhaust its appeal remedy within period of limitation. Hon'ble Court, therefore, disposed of this petition holding that respondent will not invoke bank guarantee for three months. In the meanwhile, petitioner may make all efforts before Deputy Commissioner (Appeals) to get an interim protection, pending appeal adjudication.

B. Rulings by Authority of Advance Ruling

2. VNR Seeds Private Limited – AAR Chhattisgarh (2018-TIOL-93-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is registered under GST in various states. Applicant is in business of supplying seeds (in packed form using packing material) for sowing purpose which are exempt item under GST. Applicant procure taxable packing material which are required for packing of seeds. Packing material and other consumables are also transferred from one branch / processing unit to another which are taxable under GST.

Applicant wants to use Input Tax Credit 'ITC' against payment of GST liability on account of transfers within its own branches situated in various States. In light of section 17 of CGST Act, 2017, applicant cannot avail ITC in case of units dealing in non-tax / exempted goods. Hence, applicant has requested for advance ruling for allowing to keep ITC on packing material lying in stock.

Discussions by and Observations of AAR
As per section 17(2) of Chhattisgarh GST Act, 2017, any registered recipient can claim ITC to extent of taxable stock or taxable outward supply shown in their returns. Registered recipient cannot claim ITC on amount of taxable supply component included in total amount of exempted supply. Amount of unclaimed ITC shall also be reversed in electronic credit ledger.

Thus, if applicant supplies seeds (exempt item) in packed form using packing material (taxable item) to its own branches in other States, then no ITC can be claimed on packing material used for said exempted supply of seeds. Whereas, if applicant supplies packing material to own branches in other States, then ITC could be availed as per section 17(2) of Chhattisgarh GST Act, 2017.

Ruling of AAR
Applicant is not entitled to ITC on packing material used for packing seeds, while making such exempted supply of seeds to their own branches and to other purchasers. They are however, entitled to ITC (of tax involved in purchase of such packing material) on exclusive taxable supply of such packing material made to their own branches in other states.

3. Sardar Mal Cold Storage and Ice Factory – AAR Rajasthan (2018-TIOL-94-AAR-GST)

Facts, Issue involved and Query of Applicant:
Applicant provides storage and warehousing facilities to variety of agricultural produce in cold storage house. Applicant had submitted details of various products (in Group A to Group G) and related processes done on them by farmers or cultivators or traders before products come for storage purpose. Produces do not go through any process which leads to change in essential character or enhances its marketability.

Applicant seeks clarification on following issues:

(a) Whether all goods as listed in their application are covered under the definition of agricultural produce as defined under explanation 4(vii) of Notification No. 11/2017 Central Tax (Rate) dated 28-6-2017 and at point 2(d) of Notification No. 12/2017 Central Tax (Rate) dated 28-6-2017?

(b) Whether supply of cold storage service of goods as mentioned above attracts NIL rate of tax as per Sr. No. 24 of Notification No. 11/2017 or Sr. No. 54 of Notification No. 12/2017?

Discussions by and Observations of AAR
Definition of agriculture produce as defined under explanation 4(vii) of Notification No. 11/2017 and as defined under Explanation 2(d) of Notification No. 12/2017 is reproduced as under:

"Agricultural produce" means any produce out of cultivation of plants and rearing of all life forms of animals, except the rearing of horses, for food, fibre, fuel, raw material or other similar products, on which either no further processing is done or such processing is done as is usually done by a cultivator or producer which does not alter its essential characteristics but makes it marketable for primary market."

As per above definition, agricultural produce should necessarily have three essential elements:

- It must be a produce out of cultivation of plants and rearing of all life forms.
- On which either no further processing is done or such processing is done as is usually done by a cultivator or producer which does not alter its essential characteristics, i.e., produce must broadly

retain its physical and chemical form / constitution.

- Most importantly the processing done should be such as is usually done by cultivator or producer which should only help it to attain marketability at primary market, i.e., definition limits scope of processing and allows only those activities which help produces attain the condition of its first marketability in primary market.

Issue regarding GST applicability on warehousing of 'agricultural produce' such as coffee, pulses, jaggery etc. has been clarified *vide* Circular No. 16/16/2017 GST dated 15-11-2017. The clarification deals with certain issues such as:

1. Primary Market – Green tea leaves which attain primary marketability soon after being plucked from tea plant is 'agricultural produce' and not dried tea leaves.
2. Essential characteristic – Sugarcane loses its essential characteristic when processed as jaggery. Hence, jaggery is not 'agricultural produce'.
3. Process – Dehusking and splitting or both of pulses is not carried out by farmer or at farm level, therefore pulses are not 'agricultural produce'. While pulse grain such as whole grain, rajma, etc. which are directly sold in primary market with little or no processing at farm level are regarded as 'agricultural produce'.

Based on above explanation, various products as classified under Grade A to Grade G have been classified as whether falling under the definition of agricultural produce.

Ruling of AAR

Goods mentioned under Group A fall under the definition of agricultural produce in terms of aforesaid notification and so supply of cold storage services in relation to these is exempt from levy of GST. However, if any processing is done on these products as is not usually done by a cultivator or producer at farm level, then these would fall outside the definition of agricultural produce as given in aforesaid notification and in that case supply of cold storage service in relation to these would remain chargeable to GST.

Goods mentioned under Group B to G are not agricultural produce in terms of aforesaid notification and so supply of cold storage service in relation to these would remain chargeable to GST.

Author's Remark

Ruling is facts based. Readers are requested to go through Group A to Group G given in the ruling to understand the gist of this ruling. Due to space constraints, comprehensive list of items of agricultural produce (Group A) or non-agricultural produce (Group B to Group G) are not given here.

4. M/s. Habufa Meubelen B. V. (India Liaison Office) – AAR Rajasthan (2018-TIOL-97-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is the Indian office of M/s. Habufa Meubelen B. V. ('HO') which is a company incorporated in Netherlands. Applicant is established as a liaison office with prior permission of RBI subject to certain conditions.

Applicant does not have any independent revenue or clients. Applicant does not enter into any contract with clients. All expenses incurred by applicant is claimed from HO as per clear instruction of RBI. There is no amount charged by applicant from HO for any services. Applicant seeks only reimbursement of salary and expenses such as rent, security, electricity, travelling, etc. incurred by it from HO.

Applicant has sought advance ruling in respect of following issues:

(c) Whether reimbursement of expenses and salary paid by HO to applicant is liable to GST as supply of service especially when no consideration for any service is charged?

(d) Whether applicant is required to get registered under GST?

(e) If it is assumed that reimbursement of expenses and salary claimed by applicant is a consideration towards service, then what will be the place of supply of such service?

Discussions by and Observations of AAR
Except for proposed liaison work, applicant would not undertake any activity of trading, commercial or industrial nature nor would they enter into any business contracts in its own name without RBIs prior permission. There is no commission / fee being earned by applicant for liaison activities / services rendered by it. Applicant does not have any other source of income. Applicant is solely dependent on the HO for all expenses incurred by it which are subsequently reimbursed by HO. Therefore, the HO and applicant cannot be treated as separate persons and hence, there cannot be any flow of services between them as one cannot provide service to self. Therefore, reimbursement of expenses made by HO cannot be treated as consideration towards any service.

Further, applicant is strictly prohibited to undertake any activity of trading, commercial or industrial nature nor would they enter into any business contracts in its own name. Also, reimbursement claimed by applicant from their HO is also falling out of the purview of supply of services. As there are no taxable supply made by applicant, they are not required to get registered.

Ruling of AAR
If applicant does not render any consultancy or other services directly / indirectly, with or without any consideration and the applicant does not have significant commitment powers, except those which are required for normal functioning of the office, on behalf of head office, then the reimbursement of expenses and salary paid by HO to applicant is not liable to GST and therefore applicant is not required to get itself registered under GST.

5. Merit Hospitality Services Private Limited – AAR Maharashtra (2018-TIOL-98-AAR-GST)

Facts, Issue involved and Query of Applicant
Applicant is registered as outdoor caterer under GST. Applicant is engaged in business of providing snacks and foods for breakfast, lunch, evening tea and dinner to employees of various companies. Food is prepared at applicant's kitchen and it is distributed to various companies at various locations. Applicant is carrying on aforementioned business under four different situations based on terms on contract entered as under:

Case 1
Applicant has entered into a contract for supply of food to employees of company say 'A Limited'. Contract is signed between applicant and A Ltd. for supply of food. As per terms of contract, applicant has to supply the food at A Ltd's. premises. Distribution of food is directly done by staff of A Ltd. Menu and material specifications are mentioned in contract and also the rate for various items are pre-determined between applicant and A Ltd. Billing is done by applicant directly to A Ltd. on monthly basis. Payment is received by applicant directly from A Ltd. as per terms of payment mentioned in contract.

Question: Whether on facts and circumstances of abovementioned case, can above activity be called as canteen activity and applicable rate of 5% be charged on applicant's bills?

Case 2
Facts mentioned in Case 1 remains same except that in addition to supply of food on request of client, applicant also undertake services of distribution of food for which applicant raises separate bill charging 18% GST.

Question: Can both activities put together i.e., supply and distribution of food to employees of 'A Ltd.' as canteen services and applicable rate of 5% be charged on our bills?

Case 3
Employees of 'A Ltd.' have formed "Employees Co-op. Society" which is registered under The Societies Registration Act. Employees Co-op. Society is running a canteen for employees of 'A Ltd.' Contract of supply of food of applicant is now with "Employees Co-op. Society" and not with "A Ltd."

Question: Under such circumstances can it still be claimed that applicant is running a canteen and the applicable rate of 5% be charged on applicant's bills?

Case 4
Applicant has entered into a contract with a company called say 'B Ltd.' B Ltd. is having its unit in SEZ area (Special Export Zone). Supply of food is done by applicant to employees of B Ltd. and payment for same is made by employees of B Ltd. directly to applicant.

Questions

a) Can applicant claim that since food is supplied directly to SEZ area hence no GST is applicable?

b) Can applicant claim that it is running a canteen in SEZ area hence no GST is applicable?

c) Can applicant claim that it is running a restaurant in SEZ area and hence applicable GST rate is 5% only?

Applicant has sought advance ruling on aforementioned questions.

Discussions by and Observations of AAR
Four situations have been presented before the AAR. Each situation has been studied sequentially. The fact common to all is that food is prepared at applicant's own kitchen and distributed to various companies at different locations.

Notification No. 11/2017 – Central Tax (Rate) dated 28-6-2017, under Serial No. 7 Heading 9963(i) covers accommodation, food and beverages services. Under this Notification after amendments up till now, GST @ 5% is chargeable in case of services by a restaurant, eating joint including mess and canteen as per relevant entry. In order to ascertain whether the activities of applicant would fall under Sr. No. 7, Heading 9963(i) of above referred Notification, it would be required to examine as to what a restaurant, eating joint, mess and canteen are.

"Restaurant", as per Cambridge English Dictionary is:

- A place where meals are prepared and served to customers.
- A place of business where people can choose a meal to be prepared and served to them at a table, and for which they pay, usually after eating.

However with progress of time and civilisation and further increasing demands and expectations from restaurants by customers and also restaurants with intent to further grow their businesses have started providing "take away" or even "home delivery" services to customers as per their instant order out of items that are there in menu of restaurants. Special feature to be noted is that in such cases there is no pre-entered agreement or contract between restaurant or customers except for expectations which customer has as per reputation about food and services of restaurant. From above broad essentialities of a restaurant, services being provided by applicant as per details given in Case 1 would not fall under restaurant service.

"Canteen" as per Cambridge English Dictionary is:

- A place in factory, office, etc. where food and meals are sold often at a lower than usual price.
- A place in a factory, office, etc., where employees can buy food and meals at a lower price

As per general understanding, while differentiating with a restaurant, "canteen" is a small cafeteria or snack bar, especially one in a military establishment, school or place of work while "restaurant" is an eating establishment in which diners are served food at a table and it is outside the premises of military establishment, school or place of work. Broadly, canteen is mostly referred to as an eating place provided by an organisation, college, university, military, police, government, for the staff/students workforce. In the present application, applicant has clearly stated that they are not providing services to any college, university, military, police or government but to only business organizations or companies or their employees as per different situations mentioned by applicant in its application.

Further in reference to eating joint, an "eating joint" is a quick service restaurant within the industry and is a specific type of restaurant that mainly serves fast food cuisine and has minimal table service. In same way, in common parlance a "mess" is a place where soldiers / police or any other organised force persons eat their food.

In respect of Case 1, details of supply are as under:

a) Contract is for supply of food between applicant and a company A Ltd. It is not for running a canteen.

b) Food is to be supplied at A Ltd.'s premises.

c) Distribution of food is done by staff of A Ltd. Applicant is only supplying food.

d) Menu, specifications and rate are as per contract of supply of food entered into between applicant and A Ltd.

e) Billing is done by applicant directly to A Ltd. on monthly basis and payment is received from A Ltd. as per contract.

Thus as per above details and discussions, it is clearly visible that service being provided by applicant would not be covered under Serial No. 7 Heading 9963(i) of Notification No. 11/2017 as amended.

In view of this, it is necessary to examine definition of "caterer" and "outdoor caterer" so as to see if services being provided by applicant merit classification under this service and would be liable to tax accordingly. Under service tax law, definition of 'caterer' and 'outdoor caterer' was given and same can be construed to be definition of 'caterer' and 'outdoor caterer' as per general perception as well and can accordingly be discussed and deliberated upon in respect of GST provisions.

Under the Finance Act, 1994, caterer was defined as "caterer" means any person who supplies, either directly or indirectly, any food, edible preparations, alcoholic or non-alcoholic beverages or crockery and similar articles or accoutrements for any purpose or occasion. Further under the Finance Act, 1994 outdoor caterer was defined as "outdoor caterer" means a caterer engaged in providing services in connection with catering at a place other than his own but including a place provided by way of tenancy or otherwise by the person receiving such services.

From case details as submitted in its application, applicant has stated that they are registered as outdoor caterers under the GST Act and that the company is engaged in the business of providing snacks and food for breakfast, lunch, evening tea and dinner to the employees of various companies and that food is prepared at their own kitchen and it is distributed to various companies at different locations. It is also visible that applicant is providing services at a place which is not its own and is neither provided to it by way of tenancy nor in any other way.

Thus as per case details, service being provided by applicant would clearly fall under Group 99633 – Food, edible preparations, alcoholic and non-alcoholic beverages serving services and further under service code 996337 – Other Contract Food Services which are in the nature of outdoor caterer services. In view of above

classification of services being provided by the applicant as per Case 1 would be taxable under Serial No. 7 Heading 9963(v) @ 18% under GST as applicable.

In view of detailed discussions in respect of Case 1 above, undertaking of additional responsibility of services of distribution of food by applicant would in no way impact classification or taxability of services being provided by applicant as per discussions in respect of Case 1 above.

Employees Co-operative Society running the canteen themselves would in no way impact the catering transaction with applicant. In respect of details given of Case 3, the essence of transaction between applicant and Employees Co-operative Society is not changing. Now instead of company A Ltd., outdoor catering services are being provided to Employees Cooperative Society which would be taxable @ 18% only as already discussed in respect of Case 1 and Case 2 above.

In view of details given in Case 4, it is necessary to examine provisions of IGST Act, 2017 and SEZ Act, 2005. Section 16 (1) of the IGST Act relating to 'zero rated supply' reads as under:

"Zero rated supply" means any of the following supplies of goods or services or both, namely:-

(a) Export of goods or services or both; or

(b) Supply of goods or services or both to a Special Economic Zone developer or a Special Economic Zone unit.

From detailed provisions of Section 16 of the IGST Act and Section 15 of the SEZ Act, benefit of zero rated supply to domestic unit will be allowable only if supply of goods or services are to a SEZ unit and the SEZ unit is granted a Letter of Approval by the Development Commissioner and the unit is undertaking only such operations which the Development Commissioner has authorized and every such authorized operations are to be mentioned in the letter of approval of the Development Commissioner as per the provisions of Section 15(9) of the SEZ Act.

In the case details provided by applicant in Case 4, it is not forthcoming whether B Ltd. is an authorised unit in SEZ as per Section 15(9) of the SEZ Act and as to what are the authorised operations of B Ltd. in SEZ and whether supply of food to B Ltd. or its employees is covered under authorised operations as allowed/ approved by the Development Commissioner. If it is not covered under authorised operations then this supply of food by applicant to SEZ employees would not be eligible for the benefit of zero rated supply.

In view of the detailed discussions in respect of situations of Case 1, Case 2 and Case 3 above, it is clear that the applicant cannot claim that they are running a canteen in SEZ. Rather their service would be in the nature of outdoor catering service as per discussions in detail above.

Ruling of AAR

For reasons as discussed in body of order, questions are answered thus:

Case 1

Q. Whether on the facts and circumstances of above-mentioned case can the above activity be called as canteen activity and the applicable rate of 5% be charged on our bills?

A. Answered in the negative.

Case 2

Q. Can both the activities put together i.e., supply and distribution of food to the employees of 'A' Ltd. be called as canteen services and applicable rate of 5% be charged on our bills?

A. Answered in the negative.

Case 3

Q. Under such circumstances can it still be claimed that Merit Hospitality is running a canteen and the applicable rate of 5% be charged on our bills?

A. Answered in the negative.

Case 4

Q.a. Can Merit Hospitality claim that since the food is supplied directly to SEZ area hence no GST is applicable?

A.a. In view of the findings above the said question cannot be answered.

Q.b. Can Merit Hospitality claim that it is running a canteen in SEZ area hence no GST is applicable?

A.b. In view of the detailed discussions above, the question is answered in the negative.

Q.c. Can Merit Hospitality claim that it is running a restaurant in SEZ area and hence applicable GST rate is 5% only?

A.c. In view of the detailed discussions above, the question is answered in the negative.

6. Loyalty Solutions and Research Private Limited – AAR Haryana (2018-TIOL-100-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant owns and operates a reward point based loyalty programme that is integrated towards it partners and their customers. Applicant submitted a copy of agreement with M/s. Nice Chemicals Pvt. Ltd. ('NICE') in support of its argument. For managing this loyalty programme, applicant is getting management fee and/or service charges fee. Applicant are paying GST on management fee as well service charges charged by them from NICE. The pattern of this loyalty programme is as follows:

(i) On purchase of products of "partners" to this loyally programme, end customers get reward/payment points.

(ii) These reward points can be redeemed by customers, while making future purchases of products of "partners".

(iii) In pursuance to these reward points management, "partner" transfers amount equivalent to ₹ 0.25 per reward point, as issuance charges to applicant.

(iv) Whenever any purchase is made by end customer, by using/redeeming rewards points, applicant transfers amount equivalent to ₹ 0.25 per reward point used to the concerned store. The concerned store discounts the payment to be received from end customer to this extent.

(v) The reward points have a validity period of 36 months, meaning thereby that the customer cannot redeem these reward points, after expiry of 36 months from the date of issuance.

(vi) It may happen that the customer does not or is not able to redeem the rewards points, within their validity period of 36 months from the date of issue.

(vii) In such cases, as per the agreement, the rewards points are forfeited by applicant and the amount equivalent to ₹ 0.25 per reward point is being retained by applicant.

Applicant has sought advance ruling on following issues:

(a) Whether value of points forfeited by applicant on which money had been paid by issuer of points on account of failure of end customers to redeem payback points within their validity period would amount to consideration for 'actionable claim' and therefore would not qualify as supply of either goods or services in terms of Section 7 read with schedule III of the CGST Act, 2017 and therefore would be outside scope and levy of GST?

(b) Whether value of points forfeited by applicant on which money has been paid by issuer of points on account of failure of the end customers to redeem payback points within their validity period can be treated as "supply" of any other goods or services and consequently be chargeable to GST under the CGST, HGST or IGST Act?

Discussions by and Observations of AAR

As per Section 2(i) of the CGST Act, 2017, actionable claim shall have the same meaning as assigned to it in section 3 of the Transfer of Property Act, 1882. As per Section 3 of the Transfer of Property Act, 1882, *"actionable claim is a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of movable property, or to any beneficial interest in movable property not in possession either actual or constructive, of the claimant, which the civil courts recognise as affording grounds of relief whether such debt or beneficial interest be existent, accruing or conditional or contingent."*

Schedule III to the CGST Act, 2017 provides for activities or transactions which shall be treated neither as supply of goods nor as supply of services. Point 6 in Schedule III includes actionable claims other than lottery, betting and gambling. Rewards points earned by the end customers for purchase of products of "partners" to loyalty programme are indeed "actionable claim".

However, the question arises that, when these reward/payback points are not redeemed by the customer for the reasons that their validity period has expired, do such reward points continue to be actionable claim?

In this regard, it is observed that after the expiry of validity date, these reward/payback points can no longer be redeemed/encashed by the end customer and the end customer loses any right over them. Also, as per the definition of "actionable claim", given u/s. 3 of the Transfer of Property Act, no legal action can be taken by the end customer in connection with enforcing their right over redeeming these reward/payment points. This implies that after expiry of their validity period, these reward/payment points are not "actionable claim". Consequently, the action of forfeiture of rewards/payment whose validity period has lapsed, does not mean that actionable claim been transferred, as after expiry of validity period, these reward/payback points are no longer covered under the definition of "actionable claim". Thus, the provisions of Schedule III to CGST Act, 2017 also do not come into picture, under such circumstances.

In view of above, the money equivalent to these reward/payback points, i.e., issuance fee given by partners and lying with applicant, which is retained by applicant in the name of forfeiting reward/payback points is nothing but revenue of applicant coming from the respective "partners" which has been earned by them owing to the activities of their providing services to the said "partners" through the loyalty programmes run by applicant.

Ruling of AAR

Value of points forfeited by applicant on which money had been paid by issuer of points on account of failure of the end customers to redeem payback points within their validity period would amount to consideration received in lieu of services being provided by applicant to its clients and thus would be outside the scope of being considered as 'actionable claim' other than lottery, gambling or betting and therefore would qualify as supply of services in terms of Section 7 of the CGST Act, 2017 and therefore would be within the scope of levy of GST.

Value of points forfeited by applicant on which money has been paid by issuer of points on account of failure of end customers to redeem payback points within their validity period is to be treated as "supply" of services and consequently be chargeable to GST under the CGST, HGST or IGST Act as the case may be.

7. Paras Motor Industries – AAR Haryana (2018-TIOL-101-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is engaged in business of fabrication and fitting out bus bodies on chassis supplied by its customers, who are mainly roadways corporations of various States. Bus bodies are constructed and fitted under a written contract as per specifications provided by customers.

Applicant is of the opinion that above transaction is job work and not contract for sale. Job work is defined u/s. 2(68) of CGST Act, 2017 as any treatment or process undertaken by a person on goods belonging to another registered person. Applicant relied upon judgment of Hon'ble Supreme Court in case of *'M/s. Kailash Engineering Co. vs. State of Gujarat (15 STC 574)'* wherein it was held that contract for building, erecting and furnishing of coach bodies on under frames supplied by railways was not contract for sale of goods. Applicant also relied upon judgment of Hon'ble High Court of Rajasthan dated 17-2-2017 in case of *'M/s. Mohindra Coach Factory Pvt. Ltd. vs. Commercial Tax Officer'* wherein it was held that contract for bus building / fabrication is not a sale but works contract.

Certain dealers engaged in building of body or fabrication or mounting or fitting on chassis provided by other persons has sought clarification from office of Asst. Commissioner CGST, Jaipur who has clarified as under:

'It is very much clear that the making body of buses as per customers specification on chassis provided by the other person and returning the vehicle to the supplier of chassis is covered under Sr. No. 3 of Schedule II of Section 7 of the CGST Act, 2017 and covered at Sr. No. 9 of list of services at 18% rate. As such 18% GST is leviable.'

Applicant has sought advance ruling on following issues:

(a) Whether the activity of fabrication and fitting and mounting of bus bodies on the chassis supplied by other party is job work (SAC 9988 or contract of sale of bus body HSN Code 8708)?

(b) If it is held to be job work, what rate of tax is required to be charged and paid?

Discussions by and Observations of AAR

It was observed that CBEC *vide* Circular No. 34/8/2018 – GST dated 3-3-2018 has clarified the matter as under:

S. No.	Issue	Clarification
1.	Whether activity of bus body building, is a supply of goods or services?	In the case of bus body building there is supply of goods and services. Thus, classification of this composite supply, as goods or service would depend on which supply is the principal supply which may be determined on the basis of facts and circumstances of each case.

In instant case, only the chassis was supplied by applicant's customer. No treatment or process is undertaken by applicant on the chassis itself except fitment or mounting of bus body on the same. All inputs or raw material required for fabrication of bus body has to be used by applicant from its own account and cost of these inputs do form part of value which is being charged by applicant from its customer. It is the bus body which is being fabricated and also being mounted on chassis provided by applicant's customer. Therefore, it is not merely a job work. It is supply of bus body and activity of fitting or mounting of bus body on chassis is ancillary activity to principal activity of supply of bus body. Hence, in terms of clarification issued by CBEC *vide* Circular No. 34/8/2018 – GST dated 3-3-2018, the impugned activity is a composite supply with principal supply being supply of bus body.

Ruling of AAR

Activity of fabrication and fitting and mounting of bus bodies on chassis supplied by other party is a composite supply with supply of goods, i.e., bus bodies, being principal supply (HSN Code 8707).

As activity has not been held as supply of service, second rate of tax on supply of services is not required to be spelt out in this ruling.

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CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018- TIOL-2260- CESTAT Mumbai
Case: SPM Autocomp Systems Pvt Ltd vs. CST Pune-I

Background facts of the case

The appellant has outsourced and receiving catering services from outdoor catering and inturn making available this facility to his employees & recovers the charges from the employees for providing canteen facilities. The appellants have not claimed CENVAT credit of service tax paid by them to the outdoor caterers' services availed.

The dispute is with regards to levy of service tax on the charges recovered by the appellants from their employees for providing these canteen facilities.

Arguments put forth

The appellants submitted as under:

a) Since service tax has been paid on the gross amount charged by outdoor caterers, if he is asked to pay the service tax again in respect of the amounts collected by him from his employees, it would amount to double taxes.

b) That exemption is provided *vide* entry 19A of the Mega Exemption Notification 25/2012-ST for the services provided in relation to serving of food or beverages by a canteen maintained in a factory covered under the Factories Act, 1948, having the facility of air-conditioning or central air-heating at any time during the year.

Respondents put forth

a) The amounts recovered by the appellant from their employees on account of catering services provided to their employees amounts to Service in terms of clause (44) of Section 65B of the Act, as it involves receipt of consideration. The said service is also included under the declared list of services under section 66E of the Act.

b) The employer is obliged to carry out an act (obligation to do an act) for its employees as mandated under Factories Act, 1948. Accordingly, the employer becomes the service provider and the employees become the service receiver.

Decision

a) It is the finding of Commissioner (Appeals) that the activity undertaken by the appellant is a canteen service, hence the exemption given in respect of the said taxable service cannot be denied.

b) No cogent or even an iota of reason is coming for not allowing the benefit of exemption under Notification No. 25/2012-ST dated 20-6-2012 as amended by the Notification No. 14/2013-ST dated 22-10-2013.

c) The appeal was allowed with consequential relief.

Citation: 2018 – VIL- 482- CESTAT Chennai

Case: Rane Brake Lining Ltd. vs. CGST & C. Ex. Puducherry

Background facts of the case

The appellants are into the business of manufacturing of railway brake blocks, disc pads & clutch facings. The original adjudicating authority confirmed disallowance of CENVAT credit availed by the appellants of the service tax paid on the directors sitting fees as well as on premium for product liability insurance, as proposed in SCN. The CENVAT credit on various other input services were allowed by the adjudicating authority. Hence, the present appeal is filed.

Arguments put forth

The appellants submitted as under:

a) The operative clause of the product liability insurance mentions that appellant incurred premium charges in respect of the product defects if any. The said insurance covers the risk which includes product liability, product guarantee, financial loss and product risk insurance for product linings, disc pads, clutch facings and railway brake blocks. Such expenses was incurred in order to cover the financial loss if any occurred because of defects in the finished products manufactured and cleared by the appellant and thus it has a direct nexus with the manufacturing activity carried out by them.

b) As regards the CENVAT credit of service tax paid under RCM for Director's sitting fees, it is submitted that it is incumbent upon the Director to attend the meetings and therefore the same is directly connected to the manufacturing activity of the appellant.

Respondents put forth

a) Once the goods are sold and the products are handed over to the buyers, any service availed by them would be a post-manufacturing activity and therefore the insurance policy taken for product liability cannot be held to be an input service.

b) With regard to the director sitting fee, he submitted that this has no nexus to the manufacturing activity.

Decision

a) The insurance is for covering the financial loss of the appellant / manufacturer and it cannot be considered as a post-manufacturing activity. When there are defects to the product, the appellant / manufacturer will have to recall the product and thereby incur huge financial loss. The finance / raising a capital or adjustment of finances by way of taking insurance etc. fall within the inclusive part of the definition of "input services".

b) In respect to above input service, reliance can be placed on the decision taken in *Granules India Ltd. vs.*

Commissioner of Central Excise, Hyderabad – 2017 (5) TMI 1079 – CESTAT Hyderabad, wherein the credit for service tax paid on Director's liability insurance premium was allowed.

c) As regards the credit of service tax paid under RCM on Director's sitting fees, the same is covered and allowed by in the case of *SKN Organics P. Ltd. & Anr. vs. Commissioner of Central Excise, Puducherry*.

d) The appeal was allowed.

Citation: 2018-VIL-465-CESTAT-DEL-ST

Case: H & R Johnson India vs. CCE Indore

Background facts of the case

The Appellant is engaged in manufacture of 'Ceramic Tiles (Glazed/Unglazed)'. They are also engaged in the business of trading of imported tiles. The Head Office of the appellant at Mumbai is registered with the department as an Input Service Distributor. Upon inquiry and on perusal of the invoices issued by ISD, it was found by the department that during the period from 2009-10 to September, 2013, the Appellant had availed CENVAT Credit in respect of various services viz., Advertisement, Management, Maintenance & Repair, Courier, Authorised Service Station, Manpower supply agencies, clearing & forwarding, Banking & Financial etc. on the basis of invoices issued by their ISD, which were not used in or in relation to the manufacture of their final dutiable goods. The input services, on which CENVAT credit availed, were commonly used in relation to their traded goods as well as manufactured goods. Accordingly a SCN was issued to recover the CENVAT Credit in excess of the ratio calculation as provided in Rule 6(3) of CENVAT Credit Rules, 2004.

Arguments put forth

The appellants submitted as under

c) The appellants submitted that trading activity cannot be considered as exempt service prior to the introduction of explanation, in Rule 2 of CENVAT Credit Rules, 2004, w.e.f. 1-3-2011. Since trading cannot be considered as exempt service for the period prior to that date, there is no need for the appellant to restrict or to reverse CENVAT credit attributable to such trading activity.

d) It was submitted that the department has initiated proceedings under Rule 14 of the CCR, 2004 which is bad in law since in the present case there is no dispute about the eligibility of the appellant to take credit and the only dispute is about the quantum of credit eligible to be taken.

e) It was also stated that the only statutory provision which provides for reversal of credit in such a situation is Rule 6 of CENVAT Credit Rules and the show cause notice does not allege about Rule 6.

f) Finally, it was submitted that the entire demand is beyond the period of one year and the same is time barred and liable to be set aside.

The respondent submitted as under:

a) The appellants should not have availed credit for common input services which are used for taxable output service as well as trading activity, as it is imperative to identify and reverse that amount of credit attributable to the trading activity.

b) The learned Commissioner (Appeals) is justified in the impugned order in holding that this *explanation* is clarificatory in nature and has retrospective applicability and therefore the *explanation* inserted *vide* Notification No. 3/2011 dated 1-3-2011 has retrospective effect.

Decision

e) The Bench observed that prior to 1-4-2011, there was no scope at all even to consider the trading activity to be covered under the credit scheme. After the *explanation*, the positions have become clearer to the effect that the trading activity can be considered as an exempt service for the operation of scheme under CENVAT Credit Rules. In other words, prior to that clarification, in the absence of such *explanation*, trading is not at all covered by the credit scheme. Accordingly, the appellants should not have availed credit for common input services which are used for taxable output service as well as trading activity, as it is imperative to identify and reverse that amount of credit attributable to the trading activity.

f) On a similar issue on Rule 2(e) of CCR, 2004 the Hon'ble Madras HC in the matter of Ruchika Global Interlinks – (2017)-VIL-323-MAD-ST has held that introduction of trading as an exempted service is merely clarificatory in nature.

g) On the question of extended period of limitation, it is clear that the trading is not an activity or a service covered by the CENVAT scheme prior to the introduction of clarificatory *explanation*. The appellants have no reason to avail credit on services which they are fully aware were being used for trading activity also. There is no question about the *bona fide* belief of the appellant contrary to the provisions of law.

Accordingly the appeal filed by the assessee was rejected.

Citation: 2018-VIL-468-CESTAT-DEL-ST

Case: CGST, C&CE Jaipur vs. National Engineering Industries Limited

Background facts of the case

The respondent/assessee is engaged in the manufacture of ball bearings. A show cause notice is issued to the respondent alleging thereunder that they have wrongly availed CENVAT credit on the ineligible input service rendered by the sales agents/commission agents during the period December 2014 to October 2015.The Adjudicating Authority dropped the proceeding and held that the facts of the case clearly reflect that the sale and service representative/agents were engaged by the respondent/assessee to identify/develop/ nurture market for the respondent/assessee and accordingly these are nothing but sale promotion activities. Therefore, the element of sales promotion was very much involved in the services provided by these representatives.

It was also recorded that the insertion of the *explanation vide* Notification No. 02/2016 – CE (NT) dated 3-2-2016 in the definition of "input services" clarifying that "sales promotion" include services by way of sale of dutiable goods on commission basis and, therefore, the respondent/assessee is eligible to avail CENVAT credit of service tax paid on commission to sales agents/commission agents. The Revenue preferred an appeal before the Commissioner (Appeal) and the Commissioner (Appeal) rejected the contentions of the Revenue and dismissed their appeal. The Revenue preferred an appeal before the Hon'ble Tribunal.

Arguments put forth

The Revenue as appellants submitted as under:

a) The *explanation* inserted in the Rule 2 (i) *vide* notification dated 3-2-2016 shall be effective only from the date of publication in the official gazette i.e., shall have only prospective application and that the learned Commissioner

(Appeals) has erred in applying the said *explanation* retrospectively.

b) It was further submitted that there is no nexus between the sales/commission agent activities and the manufacturing activities and that manufacturing can be undertaking without availing the services of sales/commission agent.

The assessee respondent submitted as under:

a) In the light of clarification dated 29-4-2011 in Notification dated 3-2-2016 it can safely conclude that the activity of commission agent for selling of goods/ products of the respondent/assessee is squarely covered under the scope of definition of input services provided under Rule 2(l) of the CENVAT Credit Rules, 2004. As such, the respondent/ assessee was entitled to avail the credit and the same has been correctly availed.

Decision

a) The Bench observed that whether the *explanation* added in Rule 2(l) of CENVAT Credit Rules, 2004 *vide* Notification dated 3-2-2016 has retrospective effect or not, has come before this Tribunal in the matter of *Essar Steel India Ltd. vs. CCE & ST, Surat – I reported in 2016 (335) E.L.T. 660 (Tri. – Ahmd.)* in which this Tribunal has held that the *explanation* inserted in Rule 2 (l) of Rules 2004 by Notification No. 2/2016-CX (NT) (supra) should be declaratory in nature and effective retrospectively.

b) The said decision of Essar Steel India Ltd. (supra) has been further followed by this Tribunal in a batch of matter titled as *M/s. Mangalam Cement Ltd. vs. CCE, Udaipur*, in which this Tribunal following its decision in Essar Steel Ltd. (supra) allowed the appeals filed by the appellants.

c) During the period from 2008 onwards this issue has been considered by various appellate authorities and the Board has also issued clarification *vide* Circular dated 29-4-2011 specifically under point No. 5 which contains the wording that "..... moreover activity of sales promotion is specifically allowed and on many occasion the remuneration for same is linked to actual sale. Reading the provisions harmoniously it is clarified that credit is admissible on the services of sales of dutiable goods on commission basis". From this clarification itself it is understood that if a commission agent is paid commission on account of sales of goods, his services are qualify to be input service and CENVAT credit of service tax paid on such service is admissible to the recipient of service.

Accordingly the appeal filed by the Revenue was rejected and the CENVAT Credit was allowed.

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In helping the world we really help ourselves.

— *Swami Vivekananda*

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law # 1

CP/123/CAA/2018 [TCA/157/CAA/2017]

[Before the National Company Law Tribunal-Single Bench, Chennai]

Scheme of Amalgamation between M/s. Real Image LLP ("Transferor LLP") with Qube Cinema Technologies Private Limited ("Transferee Company") and their respective Partners, Shareholders & Creditors.

If the Companies Act, 2013 allows the foreign LLP to merge with an Indian Company, then it is wrong to presume that an Indian LLP cannot merge with an Indian company and omission of such provisions in the Companies Act, 2013 is the clear case of *casus omissus*.

Brief

The Joint Company petition has been filed by Qube Cinema Technologies Private Limited **("Transferee Company")** and M/s. Real Image LLP **("Transferor LLP")** for the confirmation of Scheme of Arrangement **("Scheme")**. As per the said Scheme, Transferor LLP has to be amalgamated with the Transferee Company.

The National Company Law Tribunal, ("NCLT") Chennai has passed an order to dispense with convening the meeting of the Partners of Transferor LLP. However, it has directed to call for the meeting of equity shareholders and creditors of the Transferee Company. The Transferee Company has complied with the said order.

The Regional Director, The Registrar of Companies as well the Official Liquidator also submitted their respective reports without any objection.

The Transferee Company has submitted the following.

1. Section 60 to section 62 of the Limited Liability Partnerships Act, 2008 ("LLP Act") provides for the merger, amalgamation and arrangements.
2. Section 230 to section 234 of the Companies Act, 2013 ("CA 2013") also provides for the merger, amalgamation and arrangements.
3. The wordings of provisions of both the Act are almost identical and empowers the NCLT to sanction the scheme.
4. Under section 394(4) (b) of the erstwhile Companies Act, 1956 ("CA 1956"), the body corporate, which includes LLP, were allowed to be a transferor for amalgamating with the Company.

5. It only provides, that resultant company should be a company as defined under the Companies Act.
6. Section 232 of the CA 2013 does not contain the same language as section 394 (4)(b) of the erstwhile CA 1956,
7. The definition of foreign company under the CA 2013 includes a body corporate incorporated outside India and includes foreign LLP also.
8. Section 234 of the CA 2013 permits the merger of foreign company (which also includes a foreign LLP), in the Indian company or vice versa.
9. However, section 232 does not provide the merger of an Indian LLP in to the Indian company.

The question before the NCLT was whether in absence of any specific provision under the CA 2013, can the Transferor LLP be allowed to amalgamate with the Transferee Company?

Judgment

NCLT has allowed the merger between Transferor LLP and Transferee Company. It has made the following observations.

1. The legislative intent for enacting the LLP Act and CA 2013 is to facilitate the ease of doing business.
2. The provisions which allows the merger of body corporate including LLP with the companies under the CA 1956 is not provided under the CA 2013 and thus this is a clear case of *casus omissus*.
3. If the Parliament's intention is to permit foreign LLP to merge with an Indian company, then it is wrong to presume that an Indian LLP can not merge with an Indian company.

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Makrand Joshi, *Company Secretary*

CORPORATE LAWS

Recent Developments

Director's KYC – Frequently Asked Questions (FAQs)

The Ministry of Corporate Affairs *vide* Notification dated 5th July, 2018 amended the Companies (Appointment and Qualification of Directors) Rules 2014. Pursuant to this, every individual who has been allotted a Director Identification Number (DIN) as on 31st March of a financial year is required to file e-form DIR-3-KYC with Central Government. The Frequently Asked Questions (FAQs) on the same are as follow:

1. **What is DIR-3 KYC?**

   The DIR-3 KYC is an e-form introduced by Ministry of Corporate Affairs (MCA) *vide* notification No. G.S.R. 615(E) dated 5th July, 2018. Pursuant to the notification, MCA has amended the Companies (Appointment and Qualification of Directors) Rules 2014 and added new rule viz., 12A: Directors KYC. As per these Rules, every individual who has been allotted Director Identification Number (DIN) as on **31st March, 2018** shall submit an e-form DIR-3 KYC to the Central Government on or before **31st August, 2018**.

   For every individual who has been allotted DIN as on 31 March of a financial year, the due date of filing is on or before 30th April of immediate next financial year

2. **Whether e-form DIR-3 KYC is required be filed by individuals who are disqualified as directors under Section 164 of Companies Act 2013 as well?**

   Yes, the e-form DIR-3 KYC must be filed by all individuals who have been allotted a DIN as on 31st March, 2018, including individuals who are disqualified as directors under Section 164 of Companies Act, 2013.

3. **What is the due date for filing e-form DIR-3 KYC?**

   For every individual who has been allotted DIN as on 31st March of a financial year, the due date of filing is on or before 30 April of immediate next financial year

   For the current financial year 2018-19, for all individuals who have been allotted DIN as on 31 March 2018, the due date of filing is on or before 31st August 2018.

4. What is the filing fee for e-form DIR-3 KYC?

Filing fee for e-form DIR-3 KYC is as follows:

Sr. No.	Particulars	Amount in ₹
1.	Fee payable till the 30th April of every financial year in respect of e-form DIR-3 KYC as at 31st March of the immediate previous year	NIL
2.	Fee payable (in delayed case)	₹ 5,000/-

Note: For the current financial year (2018-19) no fee is chargeable till 31st August 2018. If the e-form is filed on or after 1 September 2018, a fees of ₹ 5,000/- shall be payable.

5. Over and above filing fees, will there be any other consequences for non-filing of e-Form DIR-3 KYC within stipulated time as mentioned above?

If the e-form is not filed within the stipulated time as mentioned in above, the DIN of such individual would be deactivated with reason as "Non-filing of DIR-3 KYC."

6. Can a deactivated DIN due to non-filing of DIR-3 KYC be reactivated?

The deactivated DIN can be reactivated after filing the e-form DIR-3-KYC alongwith the fees as prescribed by MCA, i.e., ₹ 5,000/-.

7. What details are required to be mentioned in e-Form DIR-3 KYC?

Details required to be mentioned in the e-form are as follows:

- DIN of the director
- Full name of the director
- Full name of the director's father
- Nationality and Residential status of the director
- Citizenship of the director
- PAN, date of birth, gender, mobile number, email ID, passport number, aadhar number of the director
- Present and permanent residential address of the director
- Voter Identity card number and Driving license number are optional

8. In which cases is it mandatory to mention the details of passport?

a) If not a citizen: the requirement of mentioning details of passport is mandatory.

b) If citizen of India, if such individual has a valid passport, only then it is mandatory to provide the details of passport.

c) If citizen of India, but not resident in India, if holding a valid passport, it becomes mandatory to provide the details of passport.

If the individual has a valid passport, then it is mandatory to provide details of passport because selecting "no" in the form would mean making a wrong statement.

9. In which cases is it mandatory to mention the details of Aadhaar?

In case of all individuals who are citizens of India, the requirement of mentioning details of Aadhaar is mandatory.

In case of all individuals who are not citizens of India, there is no need to mention the details of Aadhaar.

However, in case of such individuals who are citizens of India, but not resident in India, it has been made mandatory to mention the details of Aadhaar.

10. What are the attachments to be submitted in e- Form DIR-3 KYC?

Following documents/copies of documents are required to the attached in e- Form DIR-3 KYC

a) Indian Citizen

- Aadhaar Card
- Address proof for permanent address
- Address proof for present address (if different from permanent address)

Further, if the Individual has valid passport, passport is also mandatorily required to be attached to the e-form

b) Non-Indian Citizen

- Passport
- Address proof for permanent address
- Address proof for present address (if different from permanent address)

c) Indian Citizen but Not Resident in India (NRIs)

- Passport
- Aadhaar Card
- Address proof for permanent address
- Address proof for present address (if different from permanent address)

11. Whether the documents to be attached to the e-form DIR-3 KYC are required to be attested? If yes, from whom?

Yes, in case of individuals residing in India, the documents required to be attached to the e-form DIR-3 KYC are required to be attested by a practising professional (Company Secretary in whole time practice / Chartered Accountant in whole time practice / Cost Accountant in whole time practice).

Further, in case of individuals residing outside India, the documents are required to be attested in following manner:-

- If the individual is residing in a country in any part of the Commonwealth, his proofs shall be notarised by a Notary (Public) in that part of the Commonwealth;
- If the individual is residing in a country which is a party to the Hague Apostille Convention, 1961, his proofs shall be notarised before the Notary (Public) of the country of his origin and be duly apostillised in accordance with the said Hague Convention;
- If the individual is residing in a country outside the Commonwealth and which is not a party to the Hague Apostille Convention, 1961, his proofs shall be notarised before the Notary (Public) of such country and the certificate of the Notary (Public) shall be authenticated by a Diplomatic or Consular Officer empowered in this behalf under Section 3 of the Diplomatic and Consular Officers (Oath and Fees) Act, 1948 or, where there is no such officer by any of the officials mentioned in Section 6 of the Commissioners of Oaths Act, 1889, or in any Act amending the same;

- If such non-resident individual has visited India and intends to file the form, in such case, his proofs can be attested by Practising Professional as mentioned above, if he / she has a valid Business Visa. (In case of Person of Indian Origin or Overseas Citizen of India, the requirement of Business Visa shall not be applicable).

12. Whether the e-form DIR-3 KYC requires certification by way of affixation of Digital Signature? If yes, whose certification?

Yes, the e-form DIR-3 KYC requires the individual filing the form, i.e., Director, to affix his Digital signature on the form for verification of contents of the form, and additionally a certification from Practising Professional (Company Secretary in whole time practice / Chartered Accountant in whole time practice / Cost Accountant in whole time practice).

13. What does the individual i.e., Director verify / certify in the e-form?

The individual i.e., Director verifies and certifies that the following:

- The documents being attached to the e-form DIR-3KYC belong to him/ her. He/she further confirms that all required documents have been duly issued by the respective government authority and are being attached to the e-form DIR-3 KYC
- The Mobile No. and email ID belong personally to him/her
- He/She has not been declared as proclaimed offender by any Economic Offences Court or Judicial Magistrate Court or High Court or any other Court.
- He/ She has no other allotted DIN other than DIN in which changes are intimated under section 154 of the Companies Act, 2013 or a Designated Partner Identification Number under section 7 of the Limited Liability Partnership Act, 2008

He/ She shall be liable under section 448 of the Act and under relevant provisions of the Indian Penal Code, 1860 and any other law as applicable, if any statement in this application is found to be false or any material fact is found to be have been omitted.

14. What does the Practicing Professional certify in the form?

The Practising Professional certifies that he / she has:

- Satisfied himself about the identity of the applicant and his address based on the perusal of the original of the attached document.

  (In case where the applicant is residing outside India the particulars have to be verified from the documents duly attested by the attesting authority as mentioned above)
- Verified and attested the documents of the applicant based on the originals documents produced before him
- All required attachments have been completely attached to the application
- Gone through the provisions of The Companies Act, 2013 and rules thereunder for the subject matter of this form and matters incidental thereto and has verified the above

particulars (including attachment(s)) from the original records maintained by the Company/applicant which is subject matter of this form and found them to be true, correct and complete and no information material to this form has been suppressed.

- Mobile No. and email ID belong to the applicant / Director signing the form
- All the required attachments have been completely and legibly attached to the form
- Has kept a copy of the form and attachments thereto, in his records for further reference.
- Understood that he/she shall be liable for action under Section 448 of The Companies Act, 2013 for wrong certifications, if any found at any stage.

15. Can the form be filed in case of mismatch of name as per PAN database and DIN database?

Yes, the form can be filed in case of mismatch of name as per PAN and DIN`s database. The details shall get updated as per PAN database. It is also advisable to file DIR-6 as well.

16. The form requires the email ID and mobile number of individual i.e., director. If he doesn't have email ID or mobile number, can he provide e-mail ID or mobile number of any other individual?

No, in the form it is clearly mentioned that, the personal mobile number and email ID of the director is required to be mentioned. Further, the individual himself as well as the Practising Professional have to certify that the mobile number and email ID entered in the form belongs to such individual only.

Also, in e-Form DIR-3 (Application for DIN) email ID and mobile number of the director is mandatorily required.

17. Whether email ID and mobile number will be verified?

Yes, email ID and mobile number will be validated by separate One Time Password (OTP) sent on email ID and mobile number which is also required to be entered in the e-form.

18. How long One Time Password (OTP) is valid?

One Time Password is valid for only 30 minutes.

19. In case if the email ID and mobile number are not verified within time, can it be verified again? Will the One Time Password (OTP) be generated again?

Yes. OTP can be sent to a mobile number and email ID against one form, for a maximum of 10 times in a day and twice in a span of 30 minutes. For further changes, one may download a fresh form on the same day or try next day.

20. What is the liability of the director in case of providing false information?

The director shall be liable under section 448 of the Companies Act and under relevant provisions of the Indian Penal Code, 1860 and any other law as applicable, if the details provided in DIR-3KYC are found to be false or any material facts are found to be have been omitted.

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CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS
FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circular and notifications issued by RBI:

Updated through FAQs

a) FAQs – External Commercial Borrowings & Trade Credits

RBI update on FAQs on External Commercial Borrowings & Trade Credits as on July, 17, 2018 contains the following changes:

Question 19, 42 & 63 are newly inserted as under:

Q.19 Whether companies engaged in the business of Maintenance, Repair and Overhaul and freight forwarding who have been made eligible borrowers should be from airline or shipping sector only or no such restrictions apply?

Ans. Companies engaged in the business of Maintenance, Repair and Overhaul and freight forwarding eligible to raise ECBs should be from airline or shipping sector only.

Q.42 Whether ECB proceeds can be used by eligible resident borrowers for investment in their overseas JV/WOS as per the extant overseas investment regulations?

Ans. ECB proceeds can be utilised for overseas investment as permitted under the overseas investment guidelines.

Q.63 Whether SBLC can be issued by AD Category branches on behalf of their customers for availing short term trade finance from overseas lenders in Foreign currency?

Ans. AD banks can issue SBLC on behalf of their customers for availing short term trade credit from overseas lenders in foreign currency subject to such SBLCs complying with the provisions contained in Department of Banking Regulation Master Circular No. DBR. No. Dir. BC.11/13.03.00/2015-16 dated July 1, 2015 on "Guarantees and Co-acceptances", as amended from time-to-time.

Earlier FAQ was updated as on 7-6-2018.

We have discussed below few recent compounding orders issued by RBI:-

A. Parking of FDI proceeds in EEFC A/c.

1. C.A. No. 4613/2018 in the matter of S. Zhaveri Pharmakem Private Limited (Amount imposed under the compounding orders dated 7-5-2018 – ₹ 3,48,717/-)

Facts of the Case
S. Zhaveri Pharmakem Private Limited is engaged in the business of commission and indenting agents and importers and exporters of pharmaceuticals, raw materials, specialty chemicals etc.

Apart from other facts, the company received share application money of ₹ 5,42,85,000/- on 19-12-2012 and parked this amount in the EEFC account till 26-12-2012, after which it was utilised for import payment/foreign currency expenditure.

Selected Contravention
The contravention sought to be compounded related to the following:

- Parking of FDI proceeds in EEFC account: Regulation 4 of erstwhile FEMA 10 regulates the opening, holding and maintenance of Exchange Earners' Foreign Currency Account. Further, Paragraph 2 of Schedule I of erstwhile FEMA 10 lists the permissible credits to the account and FDI proceeds do not form a part of the list.

(Comments

- ***Notification No. FEMA 10/2000-RB dated May 3, 2000 has been replaced by revised Notification No. FEMA 10(R)/2015-RB - Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2015 dated January 21, 2016. Though erstwhile Notification No. 10/2000-RB dated May 3, 2000 has been replaced by revised Notification No. FEMA 10(R)/2015-RB, Paragraph 2 of Schedule I of extant Notification No. FEMA 10(R)/2015-RB corresponds to Paragraph 2 of Schedule I of erstwhile Notification No. 10/2000-RB dated May 3, 2000.***
- ***It may be noted that though parking of FDI proceeds in EEFC a/c is not permitted, parking of FDI proceeds in a foreign currency account is permitted provided the Indian investee company has impending foreign currency expenditure and such account is closed immediately after the requirements are completed or within six months from date of opening such account, whichever is earlier. General permission for opening such foreign currency account is given under Regulation 4(G)(4) of Notification No. FEMA 10(R)/2015-RB.***
- ***We have dealt with only one of the several contraventions committed by the company in this case.)***

B. ECB

2. C.A. No. 4640/2018 in the matter of M&C Saatchi Communications Private Limited (Amount imposed under the compounding order dated 14-5-2018 – ₹ 4,39,600/-)

Facts of the Case
The company is engaged in the business of advertising, and is a subsidiary of M&C Saatchi International Holdings BV, Netherlands and the ultimate holding company of M&C Saatchi PLC, UK. M&C Saatchi PLC, UK and other group companies incurred expenditure on behalf of the company i.e. M&C Saatchi Communications Private Limited in the nature of Cost-Sharing for group marketing cost and worldwide meeting expenses. The company could not pay the above dues to the group companies due to liquidity concerns. The dues remained outstanding for a period exceeding three years.

The funds were drawn without obtaining Loan Registration number (LRN) from RBI. However, RBI granted its 'no objection' for refund of outstanding payables to the overseas group entities, subject to compounding. The company refunded the said payables on February 1, 2018.

Selected Contraventions
Apart from the consequential contraventions arising upon application of provisions of Notification No. FEMA.3/2000-RB dated 3-5-2000, the primary contravention relates to raising of deemed ECB.

(Comments:

- *The compounding order implies that amounts outstanding for a period exceeding three years amount to raising deemed ECB. Care should be taken that amounts relating to intra-group payments do not exceed three years so as to be classified as deemed ECB under provisions of Notification No. FEMA.3/2000-RB dated 3-5-2000).*

C. Valuation Report

3. C.A. No. 4651/2018 in the matter of Rahul Saraf (Amount imposed under the compounding order dated 24-5-2018 – ₹ 6,65,598/-)

Facts of the Case

Safari Retreats Private Limited (SRPL) is a company incorporated under the Companies Act, 1956 on February 27, 1982. It is engaged in the construction and development of a multiplex-cum-shopping mall in Bhubaneshwar. On June 14, 2007, Banyan Real Estate Fund, Mauritius acquired 26,000 equity shares of SRPL of face value ₹ 10/- each at a price of ₹ 627/- per share for a total consideration of ₹ 1,63,02,000/- from Shri Rahul Saraf, a resident individual. The said shares were acquired by the overseas entity under the automatic route. Shri Rahul Saraf reported transfer of shares with delay in form FC-TRS to the AD bank on March 16, 2017 enclosing therewith a copy of the valuation certificate dated March 10, 2017 from a chartered accountant certifying the fair value of the shares as on June 14, 2007.

Selected Contraventions

The contravention sought to be compounded relates to the following:

- The transfer was made without adhering to the pricing guidelines: In terms of Regulation 10(A)(b)(i) of erstwhile FEMA 20/2000-RB, a person resident in India who proposes to transfer to a person resident outside India (not being erstwhile OCB) any shares or convertible debentures or warrants of an Indian company under the Foreign Direct Investment Scheme, whose activities fall under Annex B to Schedule 1, shall, subject to sectoral limits specified therein, transfer such shares or convertible debentures or warrants without prior approval of the Reserve Bank if the same is by way of sale, subject to the condition that the parties concerned adhere to the pricing guidelines, documentation and reporting requirements for such transfers, stipulated by the Reserve Bank from time-to-time. Further, as per Paragraph 5 of Schedule 1 of erstwhile FEMA 20/2000-RB, price of shares issued to persons resident outside India under Schedule 1, shall not be less than the valuation of shares done as per any internationally accepted pricing methodology for valuation of shares on arm's length basis, duly certified by a Chartered Accountant or a SEBI registered Merchant Banker where the shares of the company are not listed on any recognised stock exchange in India.

(Comments

- *Notification No. FEMA 20/2000-RB dated May 3, 2000 has been replaced by revised regulation Notification No. FEMA 20(R)/2017-RB - Foreign Exchange Management (Transfer or Issue of Security by a Person Resident outside India) Regulations, 2017 dated November 7, 2017. Though Regulation 10(4) of extant FEMA 20(R)/2017-RB dated November 7, 2017 corresponds to 10(A)(b)(i) of erstwhile FEMA 20/2000-RB dated May 3, 2000. Further, Regulation 11(2) of extant FEMA 20(R)/2017-RB dated November 07, 2017 corresponds to Paragraph 5 of Schedule 1 of erstwhile FEMA 20/2000-RB dated May 3, 2000.*

- *It may be noted that contravention for not adhering to pricing guidelines was attracted in this case since valuation report was not obtained before the event of transfer of shares from resident to non-resident even though, in principle the transfer price as certified by the valuation report of a later date was adhering to the pricing guidelines for an unlisted Indian company.)*

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CA Jayant Gokhale

In Focus – Accounting and Auditing

AUDITORS' RESIGNATIONS – CAUSES AND REMEDIES

1. Recent Alarming Trend

1.1 During the year 2018, more than 200 auditors have resigned till date. This is clearly an unprecedented number and has caught the attention of law-makers, regulators and professionals alike. Many of these resignations have been in listed companies and have in almost all cases impacted the share prices adversely. [Market price[1] of Vakrangee Ltd. and Manpasand Beverages Ltd have taken a hit from pre-resignation prices by 73% and 44% respectively]. The falling prices have hit the interests of the shareholders who (at least in principle) were the persons who appointed the said auditors. So have the auditors betrayed the interest of those whom they were appointed to protect?

1.2 The immediate reactions in the media have been critical of both, the auditors and the management. Is that really the correct approach? I have tried to analyse what could have caused the spate of resignations. After all, as professionals, we know that most audit firms make special efforts to secure appointment as statutory auditors of large companies and especially of listed companies. So what has caused so many auditors to resign after having secured appointment for a 5 year tenure. (Often with some degree of time and effort being invested in securing such appointment). Many of the resignations have come in Q4; so this decision would invariably also cause some financial loss to the auditors which bring us back to the basic questions, why the resignations and why now?

2. Why and Why Now?

2.1 The two cases that have been most in the news are the resignations of 2 of the big 4 firms from Vakrangee Ltd. and Manpasand Beverages Ltd. The reasons in these cases have *inter-alia* been given as under:-

Data in regard to election, books, bullion and jewellery was not adequate.

Significant information asked for was not forthcoming to the auditors

2.2 Others have cited different reasons including "proposed internal reorganisation in the (auditors) firm" making the continuation of audit unfeasible. Others have given vague and generic reasons such as "due to personal reasons".

2.3 Thus the requirement for the auditors to file form ADT-3 which requires the auditors to give the reasons for the resignation has largely not elicited the desired response. It appears that this reticence on the part of the auditors could be because the auditors may have very little evidence to back up detailed reasoning which would underlie disclosure of the contributory reasons that lead to the decision to resign.

1 As per Bloomberg – 30th May 2018 Article

3. Practical Situations & Difficulties

3.1 From discussion with various sections in the profession over the years I can say that numerous issues arise which make it difficult to produce evidence of such situations. These situations are however, real and undermine the basic relationship that needs to exist in carrying out an audit. To make this point adequately clear, I may mention some instances narrated to me. In some audits (especially in quarterly reviews) certain evidence is asked for and the management assures that the evidence shall be provided. At the 11th hour, the requisite data is indeed made available, but little time is left for the same to be verified fully. It later transpires that either just hours before the audit committee/board meeting, some major errors in the calculation are noticed. Often this may actually come to light even after the auditor has signed off. Another situation is one where on the insistence of the auditor, the management agreed to provide a legal opinion by a retired Judge who, as per the management was of the *prima-facie* view that the management view on the matter was correct and the adverse view being taken by the auditors was not warranted. As audit committee date draws near, the auditor is told that a conference has been held and the eminent jurist agreed with the management view. However, a written opinion is awaited. In good faith, the audit proceeds on the assumption that the management view is being supported by the legal opinion. Finally, upon the auditors strongly insisting (perhaps in writing) that the opinion be made available, a draft opinion shows that the opinion skirts the main issue under consideration. Various scenarios can arise such as a conference with the auditor being arranged, or auditor is asked to address a more specific query (which again takes a certain amount of time). All this while, the clock is ticking, the Board Meeting date is announced and a crucial piece in the jigsaw puzzle is still not in place. That's when fresh round of discussions are initiated about whether a disclaimer or qualification is necessary; whether the item is so material, can the issue not be dealt with in the next quarter by merely giving an indicative note etc. All these discussions result in enormous stress, psychological and time pressure on the management partner, his technical support team and the audit team. Finally on the last day some decision has to be taken. It requires an extremely strong auditor who can insist on postponement of the Audit Committee (AC) and Board or on issuing a modified opinion. In all such situations there is no black and white position that the auditor is dealing with. He has to deal with a hundred shades of grey in taking a professional call. Besides the time budget for the audit has gone haywire and his team, his seniors and the client company are all unhappy with the eventual outcome. Most importantly if he decides to resign he cannot prove that the client needlessly delayed the furnishing of information. The client could challenge the auditor, on many grounds such as lack of clarity, irrelevance of information (which was however belatedly provided), time constraints of the key personnel, system issues etc. Considering these situations, it is hardly surprising that the reasons cited by auditors are generally non-specific.

3.2 The management response to these issues is typically 'Trumpian'. They have often given a plethora of strong justifications/clarification none of which addresses the real issues raised by the auditor (see for example Vakrangee's statement which emphasise their adherence to accounting standards – which has never been questioned by the outgoing auditor).

3.3 Thus once can safely say that the process of ADT-3 has not proved adequate to protect the interests of the shareholders or the auditor.

4. Why Now ?

4.1 The issues and problems mentioned above are not entirely new, so why the spate of resignations in the last 7 months? I venture to put down some contributory factors.

4.2 **The increased level of regulatory supervision and oversight.** The Quality Review Board, Peer Review Board, SEBI have all taken a more hands-on and aggressive approach. RBI as a regulator too has issued a circular intimating that in case of deviations in identification of NPA's, action against auditors may follow. While this may not have caused the resignations, the hardening of the

approach of regulators is evident and its impact is bound to be felt.

4.3 **Amendment in the Companies Act 2013,** enabling action against the firm (rather than the engagement partner alone). [Refer S. 147(5)]. When seen in conjunction with the recent SEBI action of debarring PWC (and its associate firms) from undertaking attest function for 2 years and also levying a stiff monetary penalty; auditors can take this as a clear indication of the danger in event of any failure on their part.

4.4 The **opening up of class action suits** under the Companies Act 2013 has opened up a potential threat that all auditors must factor in. With increased investor activism, numerous independent governance advisories and foreign institutional investors, the informed and financially strong players who may question the auditors have changed dramatically. Earlier, so long as the management was supporting the auditors, there was no organised and informed challenge that the auditors could face. That is now history. Auditors are now becoming acutely aware of the risk that they face and therefore preferring to bail out in time rather than crash in the future.

4.5 The intense **pressure of shorter time lines** for reporting. Completion of quarterly reviews and audits within a period of 30 to 50 days poses a huge challenge. This is compounded by the rapidly changing environment such as introduction of Ind AS, new laws and regulations which auditors are not always geared up to adapt to. This only increases the pressure in the auditors, and if the client fails to adopt positive changes, quitting becomes a realistic option that has to be considered.

4.6 **Lack of professionalisation / Governance in Audit Committees (AC) and Board** in some cases. Despite the continuing effort of the Regulators, lawmakers many Indian corporates have a long way to go in achieving the required levels of corporate governance. Appointing professionals to the Board does not necessarily bring in professionalisation of the management until the independent directors start thinking of themselves as independent of the promoter group. The mind-set change cannot be brought about only by regulation. As such, even before matters reach a flash-point with the auditors, the AC must take a proper view of the matter. Where necessary, the AC must crack the whip and get the management to comply with the auditors requirements. If on the other hand, the AC in satisfied that the auditors requirements are excessive or unwarranted they must be able to understand and effectively counter the issues raised by the auditors. Since the AC comprises of independent directors, their role in resolving the deadlock, and in answering SEBI or ICAI is pivotal. Unfortunately it appears that this role may not have been adequately discharged in many of the present cases of resignation.

5. Impact of Standards on Auditing (SA)

5.1 While many have considered the auditors to be shirking their responsibility to the shareholders/ stakeholders it is necessary to take note of what Para 13 of SA 705 states: *"If the auditor is unable to obtain sufficient appropriate audit evidence the auditors shall resign from the audit".*

5.2 In similar manner, SRE 2410 "Review of Interim Financial Information" Para 39 states: *"When, in the auditors judgment, management does not respond appropriately within a reasonable period of time, the auditor should inform those charged with governance (TCWG)".*

5.3 Para 40 says that in absence of appropriate response within reasonable time by TCWG the auditors should consider **withdrawing or resigning.**

5.4 Thus when at two places the SA's which are binding on the auditors mandate a resignation (SA 705) or suggest SRE 2410, there are really few options left to the auditors.

5.5 In my view, the flaw does not lie with the auditors' approach, but in the standard. The current wording of the SA leaves room for the management to drive the auditors into a corner whereby the only option open to them is to resign. This needs to change at least in case where there is significant public interest.

6. Corrective Action – The way forward

6.1 In order to take this thought process to its logical conclusion, I am proceeding to suggest what could be the corrective measures that may be considered at least in the case of listed companies.

6.2 I may mention that ICAI too has constituted a group to consider what remedial steps need to be taken. What is given hereunder are possible steps that may be taken cumulatively or an alternative remedial measure.

6.2.1 Application Guidance - A-15 of SA 705 already requires that in case of a professional legal or regulatory requirement, auditors may communicate to the regulator in regard to such intent to resign. In the interest of resolving the matter, SEBI should depute a person for chairing a meeting between the auditor and the AC. Often issues that cannot be put in writing can be discussed more freely and this could lead to a better understanding by SEBI and the auditors / ACB. Once SEBI takes a view after properly understanding the views of the parties, even though no binding direction may be given; the view informally expressed would have great persuasive value particulars with the management. Therefore all SEBI needs to do is to mandate that before filing ADT-3 the auditors SHALL file a draft of this form with SEBI intimating his intention to resign. In such situation SEBI shall require a meeting of the ACB (not the Board) at which a representative of SEBI shall remain present to try and resolve the matter. For the reasons mentioned above, I believe that such meeting would have the necessary salutary effect.

6.2.2 A further change that could be effected is that in any event (if there is a resignation by an auditor), the auditee company shall be subject to a joint audit with one auditor appointed by the company and a joint auditor being appointed by SEBI. Such joint auditor shall be appointed for a period of 3 years and shall not be entitled to resign without consent of SEBI. This will deter any thought in the management that they can appoint some replacement who is likely to adopt an approach different from that of the auditor resigning. If the SEBI appointed joint auditor, does not face any difficulty, the matter shall stand automatically resolved. This would also enable the stand taken by the company to be fairly tested by a third party and would thus bring about resolution of the issue.

6.2.3 In addition to the above the rules of procedures of FRRB, BRB and QRB need to be amended to provide that in any case where the auditor of a company resigns, the accounts and audit papers of the year for which the resignation is effective as well as at least 1 year before and after that financial year shall be subject to review by the above mentioned Boards

6.2.4 Finally, I believe that the wording in the SA 705 para 13 needs reconsideration. The use of the term 'shall' may be suitably amended. A further Application Guidance elaborating the options that may be pursued by an auditor also needs to be put in place.

7. Conclusion

7.1 I believe that auditors do not resign casually. They do so only when the standard mandates it or where no other practical options are available. There is a view that some resignations have been given lately in order to try and avoid responsibility on the auditor. This view is not correct because whatever stand is taken by the auditor and management can always be subject matter of review. However, to maintain the confidence of stakeholders, para 6.2.3 above has already been suggested.

7.2 The recent spate of resignations have undoubtly harmed the interest of stakeholders in the company. It is however necessary for them to realise they must be vigilant in appointing auditors and in giving them the requisite independence and support; even if occasionally that may mean confronting the management. Auditor too needs to be cautious in doing due diligence before rushing to accept any and every assignment. The damage done in the few major cases of resignations till date does not appear to be very serious from a macro-perspective. However, in audit terms, the impact though not significant in terms of numbers, is a timely wake up call for corporate management, regulators and auditors. Let us hope that all of them appreciate the issues and take timely corrective action.

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Rahul Sarda, *Advocate*

Best of the Rest

1. Insolvency and Bankruptcy Code – Tripartite agreement between operational creditor, assignee and the corporate debtor

The Respondent-company was a corporate debtor of a company, 'M'. The Applicantoperational creditor advanced Rs. 30 crore to 'M' for construction of a power plant. However, when the power plant was not constructed, the Applicant requested 'M' to refund said amount of Rs. 30 crore. A tripartite agreement was entered between the Applicant 'M' and the respondent debtor that the respondent debtor would directly pay the sum of money to the operational creditor. On failure to make payment as per the tripartite agreement, the Applicant issued a notice under Section 8 of the Insolvency and Bankruptcy Code (IBC) to the respondent debtor. In response to a demand notice under section 8 of the IBC, the Respondent raised inter alia a dispute that the Applicant was not an operational creditor on the ground that the Applicant had made no averment in the application with regard to assignment of the debt.

Held, since the relationship between y 'M' and the Respondent was that of supplier of goods and services and its customer,'M' was the operational creditor and by virtue of Section 5(20) and 5(21) of the IBC, the Applicant had become the operational creditor due to assignment of the debt in its favour.

Indure (P.) Ltd. vs. B.K. Coal Fields (P.) Ltd. [2018] 95 taxmann.com 126 (NCLT – New Delhi)

2. Insolvency and Bankruptcy Code – Whether an application filed against a co-borrower to whom the loan was not disbursed be admitted?

The educational society 'PD' and the respondent company were part of the same group and intended to set up an educational institute, and accordingly approached the Applicant for financial assistance. A loan of Rs. 5 crore was sanctioned and disbursed and an agreement was executed between the Respondent, "PD', and certain individual co-borrowers on one hand, and the Applicant on the other. Due to default in repayment of the loan, the account was classified as a Non Performing Asset(NPA), and a recall notice under Section 13(2) of the SARFAESI Act was issued by the Applicant. The Respondent opposed the admission of the Insolvency and Bankruptcy Application inter alia on the ground that the loan amount was disbursed to 'PD' and not to it, and hence there was no debtor-creditor relationship between the Applicant and the Respondent.

Held: that the application for loan was signed by the one 'J' who was the Director of the Respondent and the Joint Secretary of 'PD' and even notices issued under SARFAESI Act were issued to the Respondent. Copies of equitable mortgage created in favour of the Applicant were available on the website of MCA which showed creation of charge by the Respondent in favour of the Applicant. The loan agreement was entered into by the Applicant with borrowers i.e. 'PD', the Respondent and individual co-borrowers. Therefore, it was held that there is no escape for the co-borrower Respondent in these circumstances and the application ought to be admitted.

AU Small Finance Bank Ltd. vs. Prabhu Shanti Real Estate (P) Ltd. [2018] 95 taxmann.com 223 (NCLT – New Delhi)

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Tax Articles for Your Reference

Articles published in Taxman, The Bombay Chartered Accountant Journal (BCAJ), The Chamber's Journal (CJ), The Chartered Accountant Journal (CAJ), All India Federation of Tax Practitioners Journal (AIFTPJ), Sales Tax Review(STR), Current Tax Report (CTR), Times of India and Economic Times for the period June 2018 to July 2018 has been arranged and indexed topic-wise.

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CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

Important events and happenings that took place between 7th July, 2018 and 7th August, 2018 are being reported as under:

I ADMISSION OF NEW MEMBERS

1) The following new members were admitted in the Managing Council Meeting held on 10th August 2018.

LIFE MEMBERSHIP			
1	Mr. Vakharia Dhaval Pramod Chandra	CA	Mumbai
2	Mr. Soni Narendra Premnarayan	CA	Mumbai
3	Mrs. Thakrar Gunja Ujwal	LLB	Mumbai
4	Miss Lalan Riddhi Sanjeev	CA	Mumbai
5	Mr. Vatsaraj Kush Bhargava	CA	Mumbai
6	Mr. Banwat Siddharth	ITP	Mumbai
ORDINARY MEMBERSHIP			
1	Mr. Fafadia Chetan Hasmukhrai	CA	Mumbai
2	Miss Shah Priti Arvind	CA	Mumbai
3	Mr. Choudhary Durgesh Bholaprasad	ICAI	Mumbai
4	Mr. Shinde Sachin Dattaraya	CA	Mumbai
5	Mr. Shinde Anil Gulab	CA	Mumbai
6	Mr. Doshi Viral Ashok	CA	Mumbai
7	Mr. Gupta Sachin	ITP	New Delhi
8	Mr. Khandhadia Hitesh Rajesh	CA	Mumbai

9	Mr. Aditya Ramchandran	CA	Mumbai
10	Mr. Gupta Motichand Shivpujan	CA	Mumbai
11	Mr. Mehta Aashish Jaswantrai	CA	Mumbai
12	Mr. Bafna Kshitij Suresh	CA	Mumbai
13	Mr. Thakkar Rajiv Rameshchandra	CA	Pune
14	Mr. Tambday Partha Mohan	CA	Mumbai
15	Mr. Sheth Devang Subhash	CA	Mumbai
16	Mrs. Jayashree Ramaswamy	CA	Mumbai
17	Mr. Mohanty Dillip Kumar Naresh	Advocate	Bhubaneswar
18	Mr. Lala Deepakraj Murarilal	CA	Mumbai
19	Mr. Mainkar Devdatta Suhas	CA	Mumbai
STUDENT MEMBERSHIP			
1	Mr. Pradip Ramji Parmar	ICAI	Mumbai
2	Mr. Vipul Vimalchand Jain	ICWA	Mumbai
3	Mr. Monil Deepak Shah	ICAI	Mumbai
ASSOCIATE MEMBERSHIP			
1	Hans Infotech LLP		Mumbai
2	Direct Internet Solutions Private Ltd.		Mumbai

PAST EVENTS

1. CORPORATE CONNECT COMMITTEE

The Corporate Connect committee jointly with the Indian Institute of Insolvency Professionals of ICAI (IIIPI) in association with The Institute of Chartered Accountants of India (ICAI) organised a round table meeting on "Cross-Border Insolvency Regulations" on 12th July, 2018 at ICAI Tower, Bandra, Mumbai.

Senior officials and Directors of IBBI attended this Round table conference to discuss draft regulations and policy issues for cross-border insolvency process.

2. INDIRECT TAXES COMMITTEE

A) Panel Discussion on One Year of GST- Pains, Gains and Way Forward

The Panel Discussion on "One Year of Pains, Gains and Way Forward "was held on 2nd August, 2018 at IMC. The discussion was led by Mr. V. K. Garg, President of India Award Winner & a former IRS Officer, Recognised GST Expert and Indirect Tax Expert, CA P. S. Kapoor, VP, Corporate Taxation at L & T, Mr. Divyesh Lapsiwala, Partner EY LLP and Mr. Sandeep Parikh, Vice-President of SME Association. The meeting was attended by more than 250 members.

3 LAW & REPRESENTATION COMMITTEE

A) Meeting with TDS Commissioners along with ICAI

On 16th July, 2018, representatives of the Law and Representation Committee of the Chamber along with the representatives from the Institute of Chartered Accountants of India met with a delegation of Six Commissioners of Income tax to discuss matters centering around the issue of certificates under section 197 of the Income-tax Act 1961. Suggestions were also invited from us on automating the system of issue of such certificates.

B) Representations

The L & R Committee made following Representations:

1) Representation to Mr. Rajesh Gujjar, DY GM, SEBI on Compulsory Delisting of Companies at BSE Ltd. & NSE Ltd.

2) Representation to Mr. Hasmukh Adhia, Hon'ble Finance Secretary, CBDT on Para (3) of the "Action Items" dealing with Incentive for quality orders under Part – A.

3) Representation to CCIT – TDS on various issues faced to obtain NIL/Low Witholding tax TDS order u/s. 197.

4) Representation to RBI on Filing of Entity jointly with BCAS.

5) Representation to Addl. Secretary, GST Council, New Delhi on "Proposed Amendments to the Goods and Services Tax (GST) Law"

6) Representation to the CBDT for extending the due date of filing of Return of Income due on 31st July,2018 (We are pleased to inform that extension is granted up to 31st Dec., 2018.

7) Representation on the Changes to the New Tax Audit Report to the CBDT.

(For details of the future programmes, kindly visit www.ctconline.org or refer to The CTC News of August 2018).

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Satyanarayan Maha Pooja held on 14-7-2018




International Taxation Committee

FEMA Study Circle Meeting held on Procedure for One-time compliance of recording FDT in Entity Master held on 12-7-2018

Faculties


CA Harshal Bhuta


CA Tanvi Vora

Indirect Tax Committee

Indirect Tax Study Circle Meeting held on the subject Issues in Hospitality Industry held on 11-7-2018

Faculties


CA Manish Gadia


Mr. Abhinay Kapoor, Advocate

Pune Study Group Meeting held on the subject Tax Return Filing AY 2018-2019 – Legal & Practical Aspects" and ICDS and its impact on Tax Audit Report held on 22nd July, 2018

Faculties


CA Mahendra Sanghvi


CA Nihar Jambusaria

Direct Taxes Committee

Half Day Workshop on Return Filing held on 12th July, 2018

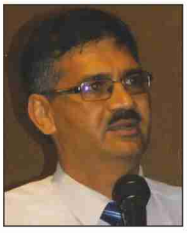
Faculties

Shri Hinesh Doshi, President giving opening remarks.

Shri Devendra Jain, Chairman welcoming the speakers and members

CA Apurva Shah

CA Avinash Rawani



CA N. C. Hegde

Indirect Taxes Committee

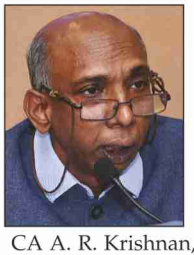
Panel Discussion on One Year of GST – Pains, Gains and Way Forward held on 2-8-2018 at IMC

CA Hinesh Doshi, giving opening remarks. Seen from L to R: CA A.R. Krishnan, Moderator, CA Naresh Sheth, Chairman

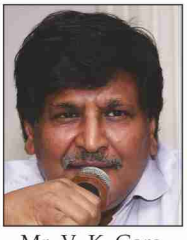
Dignitaries on the Dais

Panellists

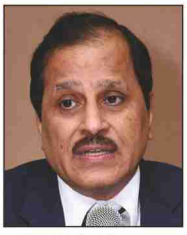
CA Naresh Sheth welcoming panellists



CA A. R. Krishnan, Moderator



Mr. V. K. Garg



CA P. S. Kapoor

Mr. Sandeep Parikh

Mr. Divyesh Lapsiwala

CA Hinesh Doshi, President presenting memento to Mr. V. K. Garg

CA Vipul Choksi, Vice President presenting memento to moderator CA A. R. Krishnan

CA Hinesh Doshi, President had meeting with Mr. Rajiv Jalota, GST Commissioner, Maharashtra on various issues of GST compliances and its procedural matters. Also seen CA Naresh Sheth, Chairman, Mr. Rahul Thakar, CA Vikram Mehta and CA Rajiv Luthia, IDT Committee members

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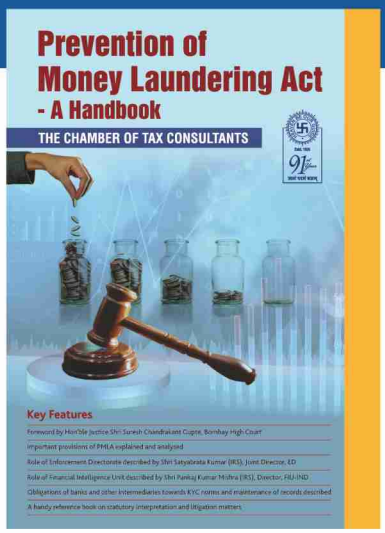

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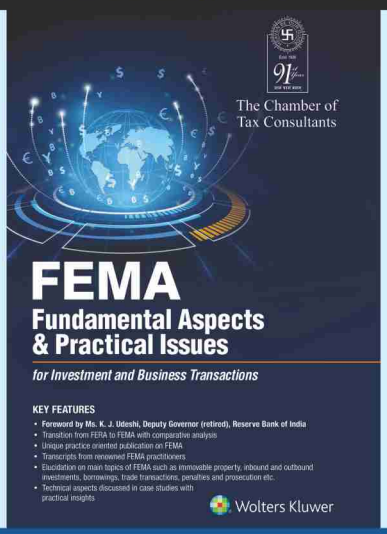

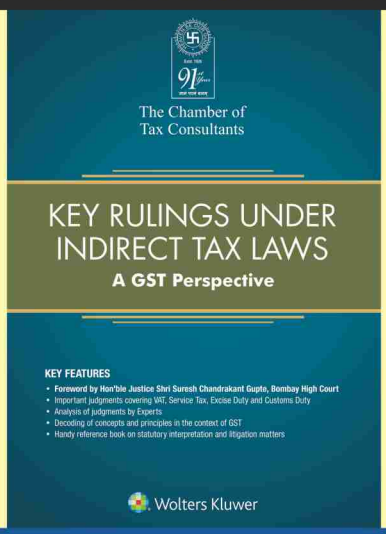

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