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A Monthly Journal of
The Chamber of Tax Consultants

The Chamber's Journal

July 2013
Vol. I | No. 10

Your Monthly Companion on Tax & Allied Subjects

Business Valuations

..... But as is rightly said, there is always a demand for the right product at right price. The valuation of companies play a critical role in the M&A market. Given the bullish outlook on India's potential domestic consumption and growing income levels (and expense levels) of Indian youth, India cannot be ignored by most multinationals seeking expansion in the not so great global economic conditions. With the hope that domestic issues specific to India will get resolved and Indian entities will continue to generate and retain interest of global investors, more deals will be struck in future – "at the right price".

(Read further from page 17 onwards)

Other Contents

Direct Taxes

International Taxation

Indirect Taxes

Corporate Laws

Other Laws

Best of the Rest

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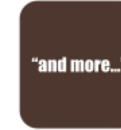
Your Questions & Our Answers

The Chamber News



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Business Valuations
Transforming Information into Knowledge
July 2013 | Vol. I | No. 10

CMYK

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C NTENTS

Vol. I No. 10
July – 2013

Editorial .... K. Gopal 5
From the President .... Yatin K. Desai 7
An Introduction to – Ved and Vedanta .... V. H. Patil 9

1. **SPECIAL STORY : Business Valuations**

1. Overview of Financial Valuations .... *Arun Gandhi* 17
2. Methods of Business Valuation (Other than DCF) .... *Parag Mehta* 21
3. Valuation using Discounted Cash Flow Method .... *Parag Ved* 24
4. Importance of Data Review (Including Future Projections) in Valuations .... *Pinkesh Billimoria & Tejas Marfatia* 28
5. Engagement Letter, Management Representations and Independent Valuation Reports .... *Vikarth Kumar* 36
6. Regulatory Aspects of Valuations (Part-I – Direct Taxes) .... *Gautam Nayak & Vishesh Sangoi* 39
7. Regulatory Aspects of Valuation–II (FEMA & SEBI) .... *Anup P. Shah* 47
8. Legal Issues and Case Laws on Valuation .... *Sharad D. Abhyankar & Mehul J. Shah* 60
9. Valuation of Intangible Assets including Purchase Price Allocation .... *Ravishu Shah* 74
10. Valuations – Investment Banker's perspective – Including Valuation issues in Negotiations .... *S. Karthikeyan* 81
11. Valuation Issues in International Transactions .... *Niraj Sanghvi* 84
12. Case Laws Index 91

2. THE DASTUR ESSAY COMPETITION – Morality and Profession .... *Shreya Yogesh Jatia* 95

3. **DIRECT TAXES**
- Supreme Court .... *B. V. Jhaveri* 108
- High Court .... *Ashok Patil, Mandar Vaidya & Priti Shukla* 110
- Tribunal .... *Jitendra Singh & Sameer Dalal* 115
- Statutes, Circulars & Notifications .... *Sunil K. Jain* 120

4. **INTERNATIONAL TAXATION**
- Case Law Update .... *Tarunkumar Singhal & Sunil Lala* 124

5. **INDIRECT TAXES**
- Central Excise and Customs – Case Law Update .... *Hasmukh Kamdar* 126
- VAT Update .... *Janak Vaghani* 128
- Service Tax – Statute Update .... *Rajkamal Shah & Naresh Sheth* 129
- Service Tax – Case Law Update .... *Bharat Shemlani* 130

6. **CORPORATE LAWS**
- Company Law Update .... *Janak C. Pandya* 134

7. **OTHER LAWS**
- FEMA Update .... *Mayur Nayak, Natwar Thakrar & Pankaj Bhuta* 138

8. **BEST OF THE REST** .... *Ajay Singh & Suchitra Kamble* 149
9. **ECONOMY & FINANCE** .... *Rajaram Ajgaonkar* 155
10. **YOUR QUESTIONS & OUR ANSWERS** .... *V. H. Patil* 158
11. **THE CHAMBER NEWS** .... *Hitesh Shah & Hinesh Doshi* 161

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Editorial

I congratulate my dear friend Shri Yatin Desai for being elected as President of the Chamber of Tax Consultants unanimously and extend my warm wishes to his team. The outgoing President Shri Manoj Shah has done an excellent job in the last one year and joins the club of Past Presidents at a very young age. This issue of the Chamber's Journal brings out a special story on 'Business Valuations'. It is said that beauty lies in the beholders eyes. The same is true, to a certain extent with respect to the value of a thing or object. The contemporary business world does not evaluate the fundamentals of an economy in exclusion of the intangibles. Intangibles are the drivers to economic growth. Thus, valuation of assets–tangible and intangible is the basis for major commercial decisions. Though valuation seems to be a science, a competent professional can convert it into a fine art. Dr. D.G. Andriessen, while writing about Value, Valuation and Valorisation, states that "Nowadays we think about money when we talk about value, but according to Crosby (1997) it was only during the Middle Ages that money developed as a means of quantifying value. Value closely related to the concept of 'Values'. According to Trompenaars and Hampdenturner (1997), values determine the definition of good and bad, as opposed to norms that reflect the mutual sense a group has of what is right and wrong. A value reflects the concept an individual or group has regarding what is desired. It serves as a criterion to determine a choice from existing alternatives."

He introduced the phrase 'Knowledge valorisation' as the transfer of the knowledge from one party to another for economic benefit. We, at the CTC are trying do 'Knowledge valorisation' for the benefit of the members with the help of Shri Sujal Shah. I thank him for his support for this venture of the Chamber's Journal. I thank all the contributors to this issue for taking out their valuable time out of their busy schedules to bring out this issue of The Chamber's Journal. Our special thanks to one of very senior professionals and a well known expert on M&A, Mr. Arun Gandhi, who agreed to write an Overview on Valuations.

The months of June and July presented before us, the macabre scenes of natural calamity in Uttarakhand which has been compounded by not just apathy but criminal negligence and lack of governance on the part of both State and Central governments. The local government of Uttarakhand and all the disaster management mechanisms froze, post the calamity; salute and thanks to the ever reliable Defence Forces which helped contain the tragedy by conducting brisk rescue operations.

The tragedy has brought to the forefront, the urgency with which we, as individuals – part of the civil society and government as an agency of policy and action need to draw margins to development which tackles the nature as an enemy to be conquered. We sat on table for discussion for too long time has come to steer the public policy towards development which is in harmony with nature.

K. Gopal
Editor

From the President

Dear Members,

Namaste! With the blessings of Almighty and my parents, I have assumed the post of President of this August body. It is indeed a moment of great pride and privilege, that all of you have shown trust and confidence in me for the prestigious position. As a President, I am also blessed with an opportunity to communicate with all of you for one year through this column.

This 87 year young organisation has a glorious past and undisputably glorious future. I have seen so many people working selflessly for it. But one person who inspires me the most is 'Patilsaab'. His refined love and affection is contagious and spread across the board. When I joined the Managing Council as an office bearer for the first time, I admit, I had no intention to continue for the next year. But after joining as an office bearer, I started enjoying the bonding amongst team members. I was eagerly waiting for the early morning weekly meetings of office bearers. The trend has continued even after five years. I still wait for the weekly meetings. This level of brotherhood and bonding only Chamber can provide. In return, I have learnt many important aspects of life such as team work, managing time to the optimum, understanding the other person's views, etc.

In my acceptance speech, I had indicated that my 36 predecessors have constantly raised standards and the levels of expectation go up with every new President. Thinking whether I will be able to live up to the expectations or not, makes me nervous. However, after looking at the wonderful team of Managing Council given to me, I feel relieved and confident. Talents win games, but team work wins Championships. By the time this column goes for printing, I would have already attended few programmes as President, arranged by the untiring Chairmen of various Committees. I would like to mention the unstinted support I have received in my tenure of last five years as an office bearer from Chamber's dedicated staff. They have unconditionally made themselves available whenever required.

I am aware the present atmosphere is of uncertainties. However, I believe, that uncertainties bring opportunities. I would like members of the Chamber to grab the opportunity to serve their clients and we will make every effort to equip members to excel in this world of uncertainties.

We are also aware that the tax practice is experiencing a paradigm shift. More and more compliances to be complied with though tax practitioners has made professional's role changed from intellectual advisers to dignified or glorified clerks who keep on feeding information to various government offices. This requires us to be innovative and keep exploring new areas of practice. It will be our endeavour on keep on innovating new ideas and subjects and practice area in carrying out our activities which provides path to professionals and fulfil their need to explore newer areas.

There is no dearth of intelligence. However, intelligence is not a substitute to education. To remain up-to-date on the knowledge front we will have a very important role to play and continue our conventional programmes like holding seminars, workshops, study circles and study group meetings.

I am fully conscious about efforts required to arrange even a smallest programme. My effort will be to have more and more joint programmes with like-minded sister organisations and to avoid overlapping programmes as far as possible.

In the recent past, our representations have received overwhelming response from some quarters of the Government and Regulatory Agencies. We will continue to voice concerns of the Members and public at large whenever required.

After its successful publication namely 'International Taxation – A Compendium', by International Taxation Committee, it has already geared up for the next publication on 'Transfer Pricing' which will include domestic Transfer Pricing as well. It will be one of its kind and members will immensely benefit from it.

The way of communication has undergone a drastic change. Learning through technology and internet is the buzz word. Physical reading material, meetings, etc. are replaced by their e-version counterparts. Literally, today everything is available on your fingertips. Smartphones, tabs and kindles with social networks has become a necessity of the day. The Chamber has already made its presence felt by recently revamping its Website and putting its prestigious journal in e-form. This year we will make every attempt to introduce some of the asynchronous learning technologies. This will require special efforts and to achieve the desired results, we have formed a separate dedicated committee, Information Technology committee. The committee will be focusing on e-learning. "E" not only means electronic but also means effective, elaborate, exciting, enthusiastic and excellent.

Apart from few initiatives mentioned above, some matters require efforts continuously. Last year the Immediate Past President, Manoj Shah had set up a daunting target of achieving Membership of 4000 from 3200. He achieved almost halfway mark. I share his views and reasons of increasing the

membership that more and more people can get benefit of knowledge spread by the Chamber. This year we shall make all effort to achieve the target. Of course, once this target is achieved, a higher target will be set. Records are meant to be broken.

The mission statement of last year, 'disseminating knowledge *creatively* inspiring excellence *collectively*' is universally true for an educational organisation. I would continue with the same mission statement.

Our economy is rain dependent economy. Too little creates drought and too much floods! Either is not good for mankind. It is therefore said, Deefle meJe$e Jepe&esled~ '*Excess of anything is bad'!* Our fellow countrymen in northern parts of India are suffering from the natural calamity due to too much in too little time. Chamber, though a not for profit educational organisation, is conscious of its social responsibility. Whenever, any need has arisen in the past, the Chamber and its Members have never looked back. The Chamber has taken a lead in helping the calamity hit people. We have already formed a committee to formulate roadmap to provide relief and rehabilitation to locals. I request each one to join hands in this noble cause. We will make necessary announcements in the Newsletter and Website once concrete plans are made.

Since last few years, it has been practice that special story of the July issue of The Chamber's Journal is of an offbeat topic. This issue is on 'Business Valuation'. The issue has been designed by our Past President CA Sujal Shah. My compliments to Sujal for a comprehensive coverage of the subject.

My role as a President will be incomplete if I don't receive suggestions and responses from all of you so keep responding with your suggestions.

I end with one of my favourite *Subhashitam* in *sanskcrit*, which I firmly believe in:

Goÿecesve efn efmeO�co3eefvle keÀe³eeefCe ve ceveesjLew: ~
ve efn meghlem³e efmebnm³e ÒeefJeMeefvle cegKes ce=iee: ~~

which means:

Goals are accomplished only by hard work and action, and not by dreams and mere intentions. Animals themselves do not enter the mouth of a sleeping lion.

Yatin Desai
President

V. H. Patil, *Advocate*

Ved and Vedanta

THE YOGA OF MEDITATION

Dhyana yoga, the yoga of meditation

The basic theme, and central ideal of Gita's teaching is realisation of your true self through yoga. Yoga itself means union of your smaller self with the Divine self.

For this purpose Bhagavad Gita prescribes that one should do his bounden duties, assigned to him by the Divine and these duties must be done without expecting the fruits of his actions, as these fruits of his actions are not for one's own use but for the use of achieving the welfare of all human beings. For that purpose Bhagavad Gita prescribes that your duty is to act and not in the fruits of your action, therefore do not do any act with a motive to have fruits and therefore do not get attached to the work. This is the prescription, for all yogas. A Jnana yoga, Karma Yoga, Sanyasa Yoga and in Chapter VI with which we are going to deal, under Dhyana Yoga, for which also the same is prescribed.

In the first shloka of Chapter VI, Lord Krishna raises a question as to whether a yogi and Sanyasi are different or one and the same and the answer to that question, is that both are the same, to achieve the same goal of self realisation to become a Dhyani, though through different paths. But ultimately, they reach the same goal of realisation, one from inside one's mind by purifying it, and other (Yogi) by working outside one's body, by doing his work selflessly for the benefit of others. Lord Krishna tells us that both of them require Dhyana Yoga for that purpose.

Now for Dhyana purpose a strong concentration of mind is required. The concentration of mind, Dhyana, requires one pointed purpose of reaching one's true self. That one pointedness requires the following things, one strong aspiration of realisation, two moderation and regularisation of life and the third Equanimity and Eveness of outlook.

To these three, two, more practices are prescribed by Lord Krsna. One Vairagya (non attachment) and two Abhyasa (constant practice).

Let us discuss these, one by one, First one pointedness. While doing Dhyani, the mind should be concentrated only on one point of self realisation. It is no doubt very difficult to do that. By nature the mind is very unsteady, roaming from one desire to another desire, then to a third desire and so on. It is very difficult to control this mind. In fact Arjuna raises this doubt to Lord Krsna, asking Him, as the mind is very unstable by nature, whether it could be controlled at all. Lord Krsna admits that it is no doubt very difficult, but by constant practice, one can achieve mastery on one's mind. It requires constant practice to achieve one pointedness of mind.

The practice of one pointedness of mind should be supplemented by purity, moderation and regulation of one's life.

Purity of life is essential for concentration. Mind should never be preoccupied with worldly matters. A man's life is not long, but even in the short span of life he can experience the eternal, divine bliss. Two, men may appear to be cast in the same mould, but one of them becomes God-like while the other sinks to the level of a beast. Why does it happen? When all are the children of God – why is there such a difference? Why does one `nara' become `Narayan' whereas the other becomes `vanara'?

There have been men in the past who have shown what great heights man can scale. Such men are there even now in our midst. This is a matter of experience. The saints have shown what a man can achieve even while remaining caged within the body. If some men can do miraculous deeds while remaining within the body, why should it not be possible for me? Why should I set bounds to my imagination? I too possess the same human body, dwelling in which others have done heroic deeds. Then why should I be in such a sad plight? There must be something outside. It is too preoccupied in finding faults in others. But why should I judge others? (Why should I be concerned with the virtues and vices of others when I myself have them in abundance?) If I remain busy in observing and criticising the faults in others, how could I have concentration of mind? Then I am bound to be caught between rajas and tamas – the mind will either wander aimlessly or it will go to sleep – it will go blank.

It is true that the Lord has given suggestions about the sitting posture, the fixing of gaze, etc. for attaining one-pointedness of mind. But they could be useful only when one has realised the need of having one-pointedness of mind. Let one realise this need; then one will seek and find for oneself the means to attain it.

Moderation and regulation in life

One more thing that aids concentration is to set bounds to one's life. All our actions should be measured and weighed. This is an essential characteristic of mathematics and it should be there in all our actions. As we take medicine in measured doses, so should be the case with our food and sleep and, in fact, with everything. All the sense-organs should be under strict vigil. We should be ever alert lest we should eat too much or sleep too much, or see what we need not. All our activities should thus be continuously examined with meticulous care.

Therefore, there should be regulation and moderation in life. Let us never look at bad things. Let us never read bad books. Let us never listen to anybody's slander or even praise. Let us turn away not only from bad things, but also from the excess of good things. Indulgence in any form should be avoided. Things like liquor, sweetmeats or fried eatables should no doubt be positively shunned, but even fruits should not be taken in excess. A fruitarian diet is certainly pure and healthy. But the fruits too should not be taken in excessive quantities. The master within should never allow the tongue to have its own way. The sense organs should feel awe for the master within; they must ever be on guard and realise that if they misbehave, they will be punished. Moderation and regulation in life means having a disciplined and regulated life.

The third thing is to have equanimity and evenness in outlook. It means having an outlook infused with goodwill, a disposition to look at the positive side of men and matters. It implies faith in the goodness and order in the universe. There cannot be concentration of mind without it. The lion is the mighty king of the forest and yet he does not take four steps forward without looking behind. How can the lion, which lives by violence, attain concentration of mind? Tigers, crows and cats are always looking here and there with apprehension. This is bound to be so with the beasts of prey. One should look at the world with a sense of equanimity. One should feel that everything in the world is good, friendly and auspicious. Just as we trust ourselves, so should we trust the whole world.

What, after all, have we to fear here? Everything is good and sacred. The universe is full of goodness,

as God is looking after it and protecting it. The poet Browning has said in the similar vein: `God's in His heaven, all's right with the world! Nothing is really wrong with the world. If there is something wrong at all, it is my vision. As is my vision, so is the world. If I put on red-coloured glasses, the world is bound to appear red and aflame.

When Saint Ramdas was writing the Ramayana, he used to read it out to his disciples. It is said that Hanuman used to come incognito to hear the same. Once Ramdas read out. "Hanuman went to Ashokvan. There he saw white flowers." Hearing this, Hanuman came forward and said, "I did not see white flowers. What I saw were red flowers. Please correct what you have written." Ramdas insisted, "No, what I have written is correct. The flowers you saw were white." Hanuman said, "I myself was there. How could I be wrong?" Finally the dispute was taken to Lord Rama. He said. "The flowers were indeed white, but Hanuman's eyes were red with anger; hence they appeared red to him." The point of this charming story is that what the world appears to us to be, depends on the way we look at it.

So long as we are not convinced that the world around us is good, our mind will not become one-pointed. As long as we think that the world around us is bad, we are bound to look around with suspicion. Poets eulogise the freedom of birds. Let them become birds for a while; they would then know the worth of that freedom. A bird is never calm. Its neck is always moving back and forth. It is always afraid of others. If you put a sparrow on the seat for meditation, will its mind attain one-pointedness? If I try to go near a sparrow, it will immediately fly away, fearing that I may hurt it. How can those who entertain the frightful idea that the whole world is out to destroy them can ever have peace of mind? So long, as a man thinks that he is his sole protector and everybody else is an enemy, he cannot attain one-pointedness of mind. An outlook that treats everybody with equality and fairness is the best means for attaining one-pointedness of mind. When you see goodness and benevolence all around, the mind will automatically attain peace.

With this background let us deal with the various shlokas of Chapter VI. The Chapter contains 47 shlokas which could be classified under the following topics.

I. Yogi (active) rises to jnani (enlightened).......1-9
II. External and internal disciplines for meditation….. 10-18
III. Controlled mind remains peaceful....... 19-24
IV. Meditation reveals self in one and all.. 25-32
V. Can a restless mind be controlled?....... 33-39
VI Yogi writes with Brahman...................... 40-47

Sri Bhagavan uvaca:
Anasritah karmaphalam karyam karma karoti yah
sa sannyasi ca yogi ca na niragnirnacakriyah 1

The blessed Lord said:

1. He who does his bounden duty without depending on the fruits of action, he is a sanyasi (ascetic) and a yogi; not the one without fire and not the one without action.

Yam Sannyasamiti praduryogam tam viddhi Pandava
na hyasannyastasankalpo yogi bhavati kascana 2

2. O Pandava, know yoga to be that which they call as sanyasa, none indeed becomes a yogi without renouncing sankalpas (thoughts).

Aruruksormuneryogam karma karanamucyate
yogarudhasya tasyativa samah karanamucyate 3

3. For a seeker who wishes to master yoga, action is said to be the means; for the one who is established in yoga, quietude is said to be the means.

Yada in nedriyarthesu no karmasvanusajjate
sarvasankalpasannyasi yogarudhastadocyate 4

4. When a man is not attached either to sense objects or actions and has renounced all sankalpas (thoughts), then he is said to be established in yoga.

Uddharedatmanatmanam natmanamavasadayet
atmaiva hyatmano bandhuratmaiva ripuratmanah 5

5. Let man lift himself by himself, let him not lower himself; his self alone is his friend, his self alone is his enemy.

Bandhuratmatmanastasya yenatmaivatmana jitah
anatmanastu satrutve vartetatmaiva satruvat 6

6. For him who has conquered his self, the self is his friend but for him who has not conquered his self, the self verily becomes hostile like an enemy.

Jjtatmanah prasantasya paramatma samahitah
sitosnasukhadukhesu tatha manapamanayoh 7

7. The supreme One, who is self-controlled and peaceful, is balanced in cold and hear, in pleasure and pain as also in honour and dishonour.

Jnanavijnanatrptatma kutastho vijitendriyah
yukta ityucyate yogi samalostasmakancanah 8

8. The yogi, who is satisfied with knowledge and wisdom, who remains unshaken, who has conquered the senses, to whom a lump of earth, stone and gold are the same, is said to be a realised One.

Suhrnmitraryudasinamadhyasthadvesyabandhusu
sadhusvapi ca papesu samabuddhirvisisyate 9

9. He who has equal regard for the good-hearted, friends, foes, indifferent, neutral, hateful, relatives, righteous and unrighteous, he excels.

I. Yogi (active) rises to jnani .. 1 – 9

The first nine verses reiterate the three stages of spiritual development described in the preceding chapter. A yogi, with worldly vasanas, needs karma yoga, the path of action, to evolve spiritually. Through action he sheds his vasanas and becomes a sanyasi. A sanyasi, in a state of renunciation, needs meditation and quietude to reach the ultimate state of a jnani. Both yogi and sanyasi head towards the same goal of Self-realisation but their sadhanas (spiritual practices) differ. Whatever the sadhana, every seeker must put in his own effort to raise himself by himself.

Yogi yunjita satatamatmanam rahasi sthitah
ekaki yatacittatma nirasiraparigrahah 10

10. Let the yogi remaining in solitude, alone, seated, with mind and body controlled, constantly practise union with the Self free from desire and possession.

Sucau dese pratisthapya sthiramasanamatmanah
natyucchritam natinicam cailajinakusottaram 11

11. Having established in a clean place a firm seat of his own, neither too high nor too low, with cloth, skin and kusa grass thereon.

Tatraikagram manah krtva yatacittendriyakriyah
upavisyasane yunjyadyogamatmavisuddhaye 12

12. There, having made the mind one-pointed, with the function of the mind and senses controlled, seated on the seat, let him practice yoga for self-purification.

Samam kayasirogrivam dharayannacalam sthirah
sampreksya nasikagram svam disascanavalokayan 13

13. Holding body, head and neck erect, still and firm, gazing at the tip of the nose and not looking around.

Prasantama vigatabhirbrahmacarivrate sthitah
manah samyamya maccito yukta asita matparah 14

14. Serene-minded, fearless, firm in the vow of brahmacharya (celibacy), the mind controlled, thinking on Me, let him sit seeking union with Me as the supreme.

Yunjannevam sadatmanam yogi niyatamanasah,
santim nirvanaparamam matsamsthamadhigacchati 15

15. Thus constantly seeking union with the Self, the yogi with his mind controlled attains peace culminating in supreme Bliss which abides in Me.

Nayasnatastu yogo sti na caikantamanasnatah
na cati svapnasilasya jagrato naiva carjuna 16

16. Verily, yoga is not for him who eats too much or does not eat at all nor for him who sleeps too much or keeps awake, O Arjuna.

Yuktanaraviharasya yuktacestasya karmasu
yuktasvapnavabodhasya yogo bhavati duhkhaha 17

17. To him who is regulated in eating and recreation, regulated in action, who is regulated in sleeping and waking, yoga becomes the destroyer of sorrow.

Yada viniyatam cittamatmanyevavatishate
nihsprhh sarvakamebhyo yukta ityucyate tada 18

18. When a perfectly controlled mind rests in the Self alone, freed from desire for all objects, then it is said to be established in yoga.

II. External and internal disciplines for meditation.... 10-18

Yogi and sanyasi are both on the spiritual path. However, the sanyasi alone, having developed a dispassion for the world, qualifies for meditation and realisation. This topic enumerates all the steps that one must take for practicing meditation. It also details the environmental, physical, mental and intellectual preparations necessary to take the seat of meditation. When a seeker follows all these preparations he will become freed from desire, possessiveness and the consequent sorrow. He will then become established in yoga and be fully prepared for plunging into meditation.

Yatha dipo nivatastho nengate sopamal smrta
yogino yatacittasya yunjato yogamatmanah 19

19. As a lamp in a windless place does not flicker – that simile reflects a yogi with subdued mind practicing union with the Self.

Yatroparamate cittam niruddham yogasevaya
yatra caivatmanatmanam pasyannatmani tusyati 20

20. When the mind, restrained by the practice of yoga, comes to rest and when seeing the Self alone by the self, it is satisfied in the Self.

Sukhamatyantikam yattadbuddhigrahyamatindriyam
vetti yatra na caivayam sthitascalati tattvatah 21

21. When he knows the supreme Bliss, which can be grasped by the intellect, which transcends the senses and wherein established he never moves from Reality.

Yam labdhva caparam labham manyate
nadhikam tatah
yasminsthito na duhkhena gurunapi vicalyate 22

22. And having obtained which, he thinks no other gain superior to It, wherein established, he is not moved even by great sorrow.

Tam vidyadduhkhasamyogaviyogam yogasamjnitam
sa niscayena yoktavyo yogo nirvinnacetasa 23

23. Let that be known as the yoga of severance from the union with pain. That yoga should be practiced with determination and with an undespairing mind.

Sankalpaprabhavankamamstyaktva sarvanasesatah
manasaivendriyagramam viniyamya samantatah 24

24. Abandoning without reserve all desires born of sankalpa (thoughts) and completely restraining the group of senses from all quarters by the mind.

III. Controlled mind remains peaceful... 19-24

Through physical, mental and intellectual disciplines one must withdraw the mind from its preoccupation with the world and direct it to the Self within. Render the mind introvert. As soon as the mind tastes the bliss of the Self it will know that there is no greater enjoyment. Being established therein, the greatest sorrow in the world cannot disturb its equanimity and peace. One practices that yoga (union with Self) through complete control of the senses and of the thought-lava which produces desires. This sets the stage for the practice of meditation and realisation of the Self.

Sanaih sanairuparamedbuddya dhrtigrahitaya
atmasamstham manah krtva na kincidapi cintayet 25

25. Little by little let him withdraw by the intellect held firm; having established the mind in the Self, let him not think of anything else.

Yato yato niscarati manascancalamasthram
tatastato niyamyaitaddtmanyeva vasam nayet 26

26. By whatever cause the unsteady and restless mind wanders away, restraining from that, let him bring it under the control of the Self alone.

Prasantamanasam hyenam yoginam sukhamuttamam
upaiti santarajasam brahmabhutamakalmasam 27

27. Verily, supreme Bliss comes to this yogi whose mind is perfectly tranquil, whose passion is calmed, who is sinless and has become Brahman.

Yunjannevam sadatmanam yogi vigatakalmasah
Sukhnena brahmasamsparsamatyantam
sukhamasnute 28

28. Thus constantly practicing union with the Self the yogi, freed from sin, easily attains the infinite bliss of contact with Brahman.

Sarvabhutasthamatmanam sarvabhutani catmani
iksate yogayuktatma sarvatra samadarsanah 29

29. United to the Self by yoga, he sees the Self in all beings and all beings in the Self, he sees the same everywhere.

Yom am pasyati sarvatra sarvam ca mayi pasyati
tasyadham na pranasyami sa ca me na
pranasyati 30

30. He who sees Me everywhere and sees all in Me. I am not lost to him nor is he lost to Me.

Sarvabhutasthitam yo mam bhajatyekatvamasthitah
sarvatha vrtamano pi sa yogi mayi vartate 31

31. He who, established in oneness, worships Me abiding in all beings, that yogi dwells in Me, whatever be his mode of living.

Atmaupamyena sarvatra samam pasyati yorjuna
Sukham va yadi va dukham sa yo9gi paramo
matah 32

32. He who, through he likeness of the Self, O Arjuna, sees equality everywhere through joy and sorrow, he is considered a supreme yogi.

IV. Meditation reveals Self in one and all 25-32

The mind in the state of meditation thinks of the Self. The intellect holds the mind single-pointedly upon the Self without allowing it to slip into any other thought. Whenever the mind wanders away the intellect brings it back through supervision and control. By maintaining single-pointed thought of the Self the mind becomes absolutely tranquil and quiet. The jnani then experiences the infinite bliss of Brahman. Thereafter, he sees the Self in all beings and all beings in the Self. He sees the supreme Being everywhere.

Arjuan uvaca:
Yo'yam yogastvaya proktah samyena Madhusudana
etasyaham na pasyami cancalatvatsthitim sthiram 33

Arjuna said:

33. This yoga of equanimity taught by you, O Madhusudana, I do not see its enduring stability owing to restlessness.

Cancalam hi manah Kqsna pranathi balavaddrdham
tasyadham nigraham manye vdyoriva suduskaram 34

34. The mind verily O Krsna is restless, turbulent, strong and obstinate; I consider it as difficult to control as the wind.

Sri Bhagavan uvaca:
Asmsayam mahabhaho mano durnigraham calam
abhyasena tu Kaunteya vairagyena ca grhyate 35

The blessed Lord said:

35. Doubtless, he mind is restless and difficult to control, O Mahabhaho, but it can be controlled by practice and dispassion, O Kaunteya.

Asmyatatmana yogo dusprapa iti me natih
vasyatmand tu yatata sakyo'vaptumi[ayatah 36

36. Yoga, I think, is hard to attain by one who is uncontrolled but it can be attained by one who is controlled by means striving.

Arjuna uvaca.
Ayatih sraddhayopeto yogaccalitamanasah
aprapya yogasamsiddhim kam gatim Krsna gacchati 37

Arjuna said:

37. The uncontrolled who possesses sraddha (faith), whose mind wanders away from yoga, failing to attain perfection in yoga, what end. O Krsna, does he meet?

Kaccinnobhayavibhrastaschinnabhramiva nasyati
Apratistho mahabaho vimudho brahmanah pathi 38

38. Fallen from both, does he not perish like a rent cloud O Mahabhaho, suportless and deluded in the path of Brahman?

Etanme samsayam Krsna chettumarhasyasesatah
tvadanyah samsayasyasya chetta na hyupapadyate 39

39. This doubt of mine, O Krsna, you should dispel completely, for there is none other than you to dispel this doubt.

V. Can a restless mind be controlled? ... 33-39

After Krsna has completed his masterly exposition of how to discipline and control the mind Arjuna doubts if the mind can ever be brought under control. He wonders how the mind, a restless, turbulent, strong and obstinate entity, can be controlled. And even if forcefully brought under control, how can the mind continue to remain steady and calm? Krsna assures Arjuna that the intellect can control the mind through sustained practice and dispassion.

Arjuna feels further confusion as to what happens to a seeker and all his efforts if he fails to attain Self-realisation in his lifetime. Will he not be denied both the material and spiritual worlds and left with neither? Krsna answers this question in the last topic of the Chapter.

Sri Bhagavan uvaca;
Partha naiveha namutra vinasastasya vidyate
Na hi kalyanakrtkasciddurgatim tata gacchati 40

The blessed Lord said:

40. O Partha, neither here nor even hereafter is there destruction for him; verily none who does good, O beloved, comes to grief.

Prapya punyakrtam lokanusitva sasvatih samah
Sucinam srimatam gehe yogabhrasto bhijayate 41

41. Having attained to the worlds of the righteous and having dwelt there for eternal years, he who has fallen from yoga is born in the home of the pure and wealthy.

Athava yoginameva kule bhavati dhimatam
etaddhi durlabhataram loke janma yadidrsam 42

42. Or he is born into a family of wise yogis only, verily, a birth such as this is very difficult to obtain in this world.

Tatra tam buddhisamyogam labhate paurvadehikam
yatate ca tato bhuyah samsiddau Kurunandana 43

43. There, united with the knowledge acquired in his former body, he strives more than before for perfection, O Kurunandana.

Purvabhyasena tenaiva hriyate hyavaso'pi sah
jijnasurapi yogasya sabdabrahmativartate 44

44. By that former practice alone, he is borne irresistibly. Even wishing to know yoga he goes beyond sabdabrahman (word-Brahman).

Prayatnadyatamanastu yogi samsuddhakilbisah
anekajanmasamsiddhastato yati param gatim 45

45. But the yogi striving with assiduity, completely purified of sins, perfected through many births, then reaches the supreme Goal.

Tapasvibhyo'dhiko yogi jnanibhyoi'pi mato'dhikah
karmibhyascadhiko yogi tasmadyogi bhavarjuna 46

46. The yogi is deemed superior to the ascetics, superior to even the wise and superior to performers of action; therefore be a yogi O Arujna.

Yoginamapi sarvesam madgatenantaratmana
sraddhavanbhajate yo mam sa me yuktatamo matah 47

47. And of all yogis, he who, with the inner self absorbed in Me, worships Me with sraddha (faith) he is considered by Me to be wholly united.

VI. Yogi unities with Brahman ... 40-47

Krsna quells Arjuna's concern that seeker falling short of Realisation in his life will be lost. He

assures Arjuna that no yogi seeking the truth will ever suffer either here or hereafter. Even if he fails to attain Self-realisation he will gain a heavenly bliss and reincarnate in a pure and wealthy home or in a family of wise yogi. The later will provide an ideal environment for him to continue his spiritual pursuit and reach the supreme goal of Realisation. Therefore, Krsna advises Arjuna to practise yoga with devotion and determination until he merges with the supreme Brahman.

Lord's Promise

In shloka 45 Lord Krsna, promise that a Yogi, striving with assiduity, is purified of taint, gradually gaining perfection, the highest goal if not in this life, in the next life, till the reaching the supreme goal.

Ultimately Krsna, compared various yogis, and asked Arjuna in shloka 46, to become a yogi.

The yogi is regarded as superior to those who practice asceticism, and also to those who have obtained knowledge (through the scriptures); the yogi is also superior to the performers of action (enjoined in the scriptures). Therefore, be you a yogi, O Arjuna.'

The best of yogis is expounded here in the Bhagavad-Gita. From the second chapter onwards, to present the highest yogi ideal, we have various thoughts and inspiration, including the great technique of meditation given in this chapter. We have Patanjali's idea of training the mind, making it calm and steady, all that is included in the yoga or practical spirituality of the Gita; Karma, Jnana, Bhakti and this Dhyana, all these are included in Sri Krsna's teaching of yoga. That is the Gita's idea of yoga. The yoga is very comprehensive; I call it `a comprehensive spirituality'. During work, during leisure, during human relations, and during meditation, such persons are in that world of yoga. `You are a yogi', that is a beautiful idea to tell a housewife. People will be wondering, `how can she, a housewife, be a yogi? A yogi is a specialised kind of human being, sitting somewhere in the Himalayas. No. `Sri Krsna says, `you are a yogi'; whatever one may be doing, `Sri Krsna whispers into the ear of all working people; `You are a yogi.' You are all to be yogis'. That is the nature of this comprehensive spirituality of the Gita.

Lord Krsna declares as under

In the last shloka Lord Krsna declares that the yogi to be superior to the other types of spiritual seekers who practice karma (action), bhakti (devotion) and jnana (knowledge). These three paths help a seeker reach the ultimate state of Brahman, the supreme Reality. However, practitioners find these paths so enchanting that they revel in their practice and lose sight of the goal. They find an end in the path instead of using it as a means to an end. The yogi signifies one whose interest and attention constantly rest on the Self. He uses the spiritual courses for the sole purpose of realising the Self.

Karma, bhakti and jnana undoubtedly help the seeker to cross over from the realm of the terrestrial to the transcendental, from mortality to immortality, from unreality to Reality. But they cannot take one all the way to Brahman. These practices purify the mind. The seeker thereafter applies the purified mind to meditation in order to realize the Self. Therefore, the seeker must not become attached to these courses. He should use them fully, but dispassionately, for crossing over to Brahman. The spiritual courses serve the seeker much the same way as a pole serves a pole-vaulter. No pole-vaulter can jump and cross the bar without the pole. Equally so no pole-vaulter can cross the bar with the pole. He uses it up to the point of climbing the height of the bar, discards the pole and then crosses over. The three types of spiritual practitioners mentioned in verse 46 hang on to the pole, that is, the practice, and therefore do not cross over to Brahman. Whereas, the yogi uses the spiritual practices with complete dispassion to reach the realm of Brahman.

The yogis tread the right path to Reality. But not all of them gain the absolute union with Brahman. Krsna extols the rare one who applies himself consistently until he fully merges with Brahman, the supreme God.

CA Arun Gandhi

Overview of Financial Valuations

1. Mergers & Acquisitions – Indian and Global Scenario

Last few years have not been encouraging for the global economy due to crisis and slow recovery in several large and developed countries. India experienced slowdown in reforms, rising interest rates, depreciating rupee and slow GDP growth. The Indian economy has also been affected due to slowdown in US and economic crisis in Euro Zone. All these have severely impacted the M&A activity in India. There is decline in the outbound deal activities by Indian Companies. Inbound investments also declined due to, decline in Country's GDP growth, Regulatory changes and high expectations in valuations.

Certain amendments in Indian laws added to the discomfort of the investors. Uncertainty created by several new (but retrospective) provisions in the Income-tax Act discouraged foreign investors from making further investments in India. On the other hand, SEBI has made certain positive changes in the new Takeover Code, which should help M&A activity in India.

But as is rightly said, there is always a demand for the right product at right price. The valuation of companies play a critical role in the M&A market. Given the bullish outlook on India's potential domestic consumption and growing income levels (and expense levels) of Indian youth, India cannot be ignored by most multinationals seeking expansion in the not so great global economic conditions. With the hope that domestic issues specific to India will get resolved and Indian entities will continue to generate and retain interest of global investors, more deals will be struck in future – "at the right price".

2. Valuation concept

When business or shares are transferred from one entity to another, it becomes very important for both buyer as well as seller to know what is the worth of that particular asset which is being transferred. The process which is undertaken to know the worth is commonly known as "Valuation". It is popularly said that "Price" is what you pay and "Value" is what you get. "Value" refers to the worth of an asset, whereas "Price" is the result of a negotiation process between a willing but not an overeager buyer and a willing but not an overeager seller. In simple terms, valuation is a process of determining value of a company or an asset. Valuation is an art and not an exact science. The valuation exercise of same

asset attempted by two valuers could be different as the valuation is influenced by valuer's judgment on various parameters.

Depending on the structure of the transaction, there may be a need to value Shares of the Company or a particular business or an intangible asset. The importance of intangible assets such as brands, patents, intellectual property rights, human resources, etc. is increasing and the valuation of such assets is also becoming a more common phenomenon.

3. Why valuation?

Valuation is called for in various situations; some of them are listed below:

a) Purchase/Sale of Business/Shares:

Valuation plays an important role in case of takeover/acquisition of business/shares of a company. A valuer needs to apply appropriate valuation methodologies depending upon the nature of business being transferred and the industry to which it belongs. Also in case of acquisition of shares, one may have to consider controlling premium depending upon the stake being acquired or an illiquidity discount in case of unlisted company.

b) Merger:

In case of merger, one needs to determine the share exchange/ swap ratio i.e. number of shares of transferee company to be allotted to the share holders of transferor company. The attempt is to arrive at the relative value of the shares of the transferor and transferee company. Absolute value of the shares has limited significance in case of determination of share exchange/ swap ratio. Lately, in case of merger involving listed companies, SEBI has been entrusted with more powers to protect the interest of minority shareholders.

c) Demerger:

Demerger involves transfer of undertaking from one entity to other. The resulting company issues shares to the shareholders of the demerged company, which is based on the share entitlement ratio to be recommended by the valuer.

d) Regulatory requirements:

Recently there have been many regulatory changes governing valuations under FEMA as well as Income-tax Act. Reference to erstwhile CCI Guidelines has been completely removed from FEMA. As per the recent changes, in case of transfer of shares of an Indian company between resident and non-resident, valuation needs to be done using DCF method.

Under Income-tax Act, transfer of shares of companies in which public are not substantially interested for nil/inadequate consideration is subjected to tax at fair value. The fair value needs to be determined in accordance with Rule 11UA of the Income Tax Rules.

e) Family Settlement:

Under this situation, valuer needs to consider the terms and conditions agreed between the family members for separation of various assets. It may call for separate valuation of physical assets being immovable properties, plant and machinery, family jewellery, etc. in addition to valuation of business.

f) Impairment testing:

As per Accounting Standard – 13, 'Accounting for Investments', long-term investments are usually carried at cost. However, when there is a

permanent diminution in the value of such investment, the carrying amount needs to be reduced to recognise the diminution. To ascertain this diminution, valuation of such investment needs to be carried out.

g) Purchase Price Allocation:

When a business is acquired for a lump sum consideration, the purchaser needs to allocate the consideration over various assets (tangible as well as intangible) acquired; for the purpose of recording in the books of account and also for tax purpose. Valuation, therefore, becomes an important aspect for purchase price allocation.

h) Portfolio value of investments:

In the recent past, private equity funds have entered Indian markets in a big way. Many funds have invested in listed and unlisted Indian stocks. These funds track their investments on a regular basis to arrive at mark to market value of the investments for reporting the portfolio value to their investors. These funds either carry out the valuation internally or hire professionals to determine the portfolio value.

The purpose of valuation needs to be understood before commencement of the valuation exercise. The structure of the transaction also plays very important role in determining the value. The 'general purpose' value may have to be suitably modified for the special purpose for which the valuation is done. The factors affecting that value with reference to the special purpose must be judged and brought into final assessment in a sound and reasonable manner.

4. Valuation methodologies

Valuer may use different valuation methodologies for valuing the shares of a company/business. Though different values are arrived under various methods, it is necessary for a valuer to arrive at a single fair value.

As mentioned earlier, selection of appropriate valuation methods also depends on the purpose of valuation. If the valuation is for a merger, the valuer would value the companies involved in a similar manner to arrive at a relative value.

Following are generally accepted methodologies for valuation of shares / business:

a) Net Assets Method

b) Discounted Cash Flow Method

c) Earnings Capitalisation Method

d) Comparable Companies Multiple Method

e) Market Price Method

5. What is fair value?

Valuation is largely influenced by the valuer's judgment, knowledge of the business, analysis and interpretation and the use of different methods, which may result in assigning different values based on different methods. It is more an application of knowledge after analysing various supportive data obtained either from the management or through other publicly available sources.

Once the 'value' is determined, what follows is detailed negotiations between the purchaser and seller and if there is an agreement between the two, 'price' of the asset (whether of shares or business) gets established. It is quite possible that the price is either far higher or far lower than

the fair value. It is important to keep this differentiation between price and value in mind before attempting the valuation. Some of the instances of such cases are cited below:

Buyer's perspective

A buyer while valuing a business takes into account business synergies, administration cost savings, tax benefits that he may enjoy on acquisition of such business. These benefits indirectly get captured in the buyers' side valuation.

Seller's perspective

A seller while selling a majority stake in a company would like to add control premium over and above the fair value arrived for the business.

Listed stock

In case of listed shares, market price may not necessarily represent the fair value. One may have to look at various factors such as trading volumes, % of public shareholding, etc. In case of investment companies, generally market discounts the value of the investments held, which does not reflect the fair value of these investments.

Unlisted stock

Shares of unlisted companies are not saleable easily, therefore general practice has been to apply illiquidity discount in such cases.

6. Role of professionals

Management of companies always sought help of Professionals like Chartered Accountants or Investment Bankers to value the intrinsic worth of business/ shares using various techniques of valuation. Valuers have to be extra cautious in carrying out valuations as they are accountable to various bodies – share holders, company, regulatory authorities. Some of the important aspects that need to be taken care of are listed below:

a) Understanding the nature of transaction

b) Proper understanding of the business and the industry scenario

c) Back up of data used for valuation

d) Representation letter on various information received from the management

e) Filing of working papers

f) Format of the valuation report giving details on data considered, information received, methods used, factors considered for valuation, the final recommendation and also the scope limitations.

7. To conclude

It should be noted that valuation is not an arithmetical or a mechanical exercise. The valuer has to take extra efforts to have full understanding of the nature and ingredients of the transactions, different structures being used to carry out the transaction and their impact on valuation. Valuation is an expression of an opinion of a valuer. While expressing his opinion, the valuer needs to highlight important factors affecting that valuation and also point out to the user of the valuation about any limitations. One should keep in mind that there cannot be a fixed set of rules for carrying out valuation. However the valuer needs to ensure fairness to all stakeholders.

CA Parag Mehta

Methods of Business Valuation (Other than DCF)

To carry out valuation of a company, certain fundamental factors that affect the wealth generating capability of the company should be considered. These include:

- The general economic outlook as well as the current and expected conditions in the business environment and the industry's relationship with the economy
- The competitive environment prevailing within the industry
- The relative competitive advantages of the business in terms of the service capability, management capabilities and the quality of the clients of the entity
- The historical financial and operational performance of the business, etc.

To determine the value of enterprise, three traditional approaches can be considered:

A] Market; B] Income and C] Cost approach

In this article, we have discussed market approach and cost approach.

A. Market approach

Following are the key sub-methods of the market approach.

1. Market price method

If the valuation subject's equity shares are traded on the stock exchanges, the valuation of the company based on the market price provides a very objective benchmark. In such cases, the value of the business is expressed as follows:

- o Value of business = Market capitalisation of the Company (No. of shares outstanding multiplied by the market price) + Gross debt – Cash and cash equivalents

  The valuer needs to analyse the following factors for considering the market price method:

  a) Whether the shares are frequently traded

  b) Reasons for sudden changes in the market price of the equity shares company.

Market price method reflects value of equity shares based on transactions between

investors holding minority equity stakes in the company.

2. Price of recent investment (PORI)/ Price of recent transaction method (PORT)

In case of unlisted companies, recent investment or transaction in the firm's equity shares at arm's length is considered if the transaction has resulted in material change in shareholding structure of the company. Recent investment provides a good indication of the fair market value of a company. It may be noted that typically transactions involving rights issue are not considered for valuation.

The valuer needs to consider the following factors while using PORI/PORT method:

a) The investment or transaction should be recent.

b) There have not been any significant positive or negative changes in the company or in the industry in which the company operates after the transaction.

3. Comparable Companies' Multiples (CCM) method

This method uses multiples derived from valuations of listed comparable companies operating in similar space (known as comparable companies' quoted multiples) or valuation based on transactions/M&A deals involving comparable companies (known as transaction multiples). The method is based on the principle that 'comparable transactions/ market valuations', taking place between informed buyers and informed sellers, incorporate all factors relevant to valuation.

The process involves identification of comparable companies operating in similar businesses. After selection of comparable companies, a comparison of the valuation subject with comparable companies is carried out on various financial parameters (sales/ profit growth, profit margins, return on capital employed) and industry specific factors (e.g. growth in subscribers for telecom companies). Further, the valuer should also consider whether there are any temporary factors impacting the multiples of comparable companies. Multiples are derived for selected companies and applied to the firm's operating metrics. Relevant multiples are further adjusted for differences between the circumstances. A comparative SWOT analysis of the companies and valuation subjects helps in estimating required adjustments. Earnings (operating) based multiples are usually considered better for analysis (as compared to sales or asset multiples which are typically used for benchmarking purposes) since they provide a better reflection of the wealth generating ability of the companies. Further, forward multiples of comparable companies may also be considered on a case specific basis.

Multiples are applied to current and/or future maintainable profits/sales/etc. of the company.

Following process is considered while carrying out valuation as per CCM method.

- Value of the company is derived from the value of comparable market prices of other companies or acquisition prices realised by companies of a similar character.
- The value of a company [Enterprise Value ("EV") or the value of equity] can be expressed as a multiple of a financial/ operating parameter.
- Multiples may be determined and applied in one of two ways, which yield as their results:
    - o Enterprise Value (EV, Gross Value) – market value of the company as a whole, or

  - o Equity Value (Net Value) – market value of equity

- The following ratios are generally used:

  - o Earnings multiples are calculated on the basis of earnings:

    - ☐ EV/EBIT (Earnings Before Interest and Tax),

    - ☐ EV/EBITDA (Earnings Before Interest, Tax, Depreciation, and Amortisation),

    - ☐ Price/Earnings Ratio

  - o Asset multiples are calculated on the basis of the book value of equity or book value at enterprise level

    - ☐ Price/Book Value of Equity

    - ☐ Enterprise Value/Book Value of Operating Assets

  - o Industry specific benchmarks such as EV per subscriber (telecom industry), or EV per ton of capacity (Cement/Steel industry) are also considered.

The valuer needs to take into account the following factors when using this method:

- Valuation performed using CCM method represent minority stake therefore does not include a control premium. Valuation as per CTM method may or may not include control premium (depending on the amount of stake bought or sold in the transactions)

- Valuer may need to assess applicability of liquidity/marketability discount in case CCM method is being considered.

CCM method helps in objective value assessment based on publicly available benchmarks. However, identification of comparable companies remains a challenge in certain case.

B. Asset approach

The asset approach seeks to determine the business value based on the value of its assets.

- Net Asset Value is the book value of the assets of a business less its liabilities. This method arrives at valuation in terms of stated net worth of the company. Variations of this method use depreciated replacement cost of fixed assets or net realisable value (break-up or asset-by-asset sale basis).

- This method is used when valuation under this method is expected to be higher compared to other valuation methods. Valuation as per NAV method may be higher in case of companies making low profits or losses or when the business is about to be closed down and cannot be considered a going concern.

- In distress situations or during market downturns, value as per NAV method tends to be higher than the market value and hence become more relevant.

Limitations of NAV method

- Does not take intangibles into account

- Ignores future growth potential of the business

- Impacted by accounting practices

CA Parag Ved

Valuation using Discounted Cash Flow Method

Overview

Discounted Cash Flow (DCF) Method of Valuation is gaining importance in the recent past. It got a boost when Reserve Bank of India has recognised DCF as the only method under FEMA, for transactions between Residents and Non-Residents for shares of Indian Company. DCF is also one of the recognised methods under section 56(2)(vii)(b) of the Income-tax Act.

Internationally DCF is given more importance since it is universal method. In theory, irrespective of the GAAP you follow, the net cash generated by an Enterprise should not change. Thus for International acquisitions, more reliance is placed on the value under DCF method.

Is DCF superior?

Advocates of DCF argue that it scores over other traditional methods of valuation as it takes into account cash requirement for working capital and capital expenditure, financial gearing of the enterprise, etc. which are not given much importance under the traditional methods of valuation like PECV, EV/EBITDA, Net Assets, etc.

On the other side, traditional methods are easy to comprehend. They are generally based on the historical data which one can vouch. Whereas DCF is entirely based on the future projections. Each and every item of projections, i.e. Capacity Utilisation, Volume, Price, Raw Material Cost, Manufacturing and Other overheads, requirement for Capital Expenditure and Working Capital, etc. are all assumptions. In the dynamic world it is very difficult to predict what will happen 6 months down the line and still projections are made for 5 to 7 years. I am yet to see a projection which is actually achieved.

In my view both DCF and traditional methods are equally important as they give perspective about the historical performance of the Enterprise and its future expectation.

Discounted Cash Flow Method

DCF method proceeds on the assumption that "Cash is King". The DCF method values the business by discounting its free cash flows for the explicit forecast period and the perpetuity value thereafter. The free cash flows represent the cash available for distribution to both the owners and the creditors of the business.

Approaches to DCF

There are two broad approaches for valuation as per DCF Method. The Free Cash Flow to Equity (FCFE) approach and the second is the Free Cash Flow to Firm (FCFF) approach.

— **FCFE:** Under this approach, the value for equity holders is obtained by discounting expected cash flows available for the equity holders. Cash flows to equity holders is arrived by reducing from gross operational cash flows, tax payments, amount required for incremental working capital, capital expenditure, interest payment, principal repayment for loans, etc. The net cash flows so arrived are discounted by the cost of equity.

— **FCFF:** Under this approach the value of the firm is obtained by discounting the expected cash flows to the firm or the enterprise. Cash flows to firm are arrived by reducing from gross operational cash flows, tax payments, amount required for incremental working capital, capital expenditure, non-cash expenditure (depreciation), etc. In this approach, the free cash flow is discounted by Weighted Average Cost of Capital (explained in subsequent paragraphs). The gross value of the enterprise is arrived and from this value, amount of loan as on the valuation date is reduced to arrive at the value for equity holders.

In practical scenario, FCFF is used more frequently and FCFE is used in cases where the cash flows are more predictable, for example, Road Projects with Annuity Payments.

Estimation of cash flows

As stated earlier, DCF valuation is arrived by taking the present value of expected future cash flows. Thus it is very important to consider the reasonable projections which the enterprise can achieve. It is a known fact that nobody can predict what the future will be. Thus while considering the projections instead of being optimistic or pessimistic one has to be realistic.

Following are the factors that need to be considered while reviewing the projections:

— **Appraisal by institutions and understanding of the business** – If the projections are appraised by any financial institution or a bank, the acceptability of the same is far higher as compared to unapprised projections.

— **Industry/Company Analysis** – While reviewing the projections, it becomes very important to understand the industry to which the Company belongs and the other players operating in the same industry. It is also very much required that regulatory aspects applicable to the industry are thoroughly reviewed. For eg. there are certain restrictions for the sugar industry for sale of their products. Similarly Iron Ore industry had certain restrictions for export of materials.

— **Dependence on single customer/ supplier** – If the Company is dependent on single customer or supplier, it increases the risk of achieving the projections in case of default by them. In such situations a higher discount rate is applied to capture the underlying risk.

— **Installed capacity** – In case of manufacturing Companies there are instances that during the projection period the projected production quantity exceeds the installed capacity. The reviewer has to take care to ensure that appropriate capital expenditure is projected to capture the extra capacity requirement or the projections for production quantity is restricted upto the reasonable level of installed capacity.

— **Income tax rate and surcharge** – Tax is one of the major cash outflows for most of the profit making companies. If the Company is enjoying any tax benefit, it needs to be captured after taking into account the period upto which it is available.

— **Working capital requirements** – The underlying assumptions for Debtors, Creditors and Inventories have to be thoroughly reviewed by comparing the same with the historical data / past trends.

— **Alternate scenarios / sensitivities** – The projections need to be tested for sensitivity

of critical assumptions such as Foreign Exchange rates, expected inflation, input-output ratio, etc.

Each activity of the company needs to be identified and the **revenue assumptions** need to be made for each stream of income. An appropriate **Growth rate** has to be applied to this considering the past trend of the enterprise, present and expected capacity utilisation of the enterprise, expected trend in the industry, etc. **Various cost and expenditure** needs to be bifurcated into variable cost and fixed cost. The variable cost should be related to the revenue assumptions/activity of the company whereas fixed costs will be mainly time cost.

Discount rate

The discount rate is the most critical item of DCF valuation. The Cash Flow arrived will have to be discounted by an appropriate rate. What is an appropriate rate is subject matter of discussion. In theory, the discount rate should adequately reward the investor for the risk he is taking by investing in an enterprise. Thumb rule is that higher the risk, higher should be the discount factor and lower the risk, lower should be the discount factor. The discount rate is arrived by determining the cost of each provider of capital and taking the weighted average of that. The discount rate so arrived is termed as Weighted Average Cost of Capital (WACC). The WACC reflects the business as well as financial risk of the enterprise. Each component of WACC is discussed in detail in the following paragraphs.

— **Cost of equity:** The cost of equity is the most important number in the DCF calculation. It signifies the rate of return expected by the investor for putting his money into the enterprise. Large investors will have their own return expectation. In that case the return indicated by the investor becomes the cost of equity.

In the absence of such indication one can refer to Capital Asset Pricing Model (CAPM) to determine cost of equity. Under CAPM, the cost of equity is defined as under:

Cost of equity = Risk Free Return + [Beta * Equity Risk Premium]

Where,

Risk Free Return: is the return expected by an investor where there is no default risk and there is no reinvestment risk.

Beta: It is the sensitivity of a particular stock vis-a-vis Market or Index. Arithmetically, beta can be calculated as follows

$$\text{Beta} = \frac{\text{Covariance (X,Y)}}{\text{Variance (X)}}$$

Equity Risk Premium is the expectation of the investor over and above the risk free return.

Equity Risk Premium = return generated by the market - risk free return

— **Cost of Debt**

Cost of Debt is the long-term cost of debt of an enterprise. Interest on the debt is a tax-deductible item. Thus any enterprise would like to leverage on that and borrow funds to meet its requirements. While arriving at Cost of Debt, one has to take the tax benefit available on interest and take cost of debt net of tax.

— **Cost of Preference Shares**

Cost of preference shares is the dividend rate of the preference share along with the applicable dividend distribution tax.

— **Weighted Average Cost of Capital (WACC)**

The Weighted Average Cost of Capital is the weighted average of the costs of the different components of financing used by an enterprise. Arithmetically, WACC is calculated as follows

WACC = [(Cost of Equity*Weight) + (Cost of Debt*Weight) + (Cost of Preference Shares*Weight)] / [Weight of Equity + Weight of Debt + Weight of Preference Shares]

To arrive at the weights of the different components of financing used by the enterprise, one has to consider the sustainable financing pattern of the enterprise and also of the industry in which it operates.

Calculation of terminal value

Discounted Cash Flow Valuation is calculated in two parts, i.e. present value of cash flow for explicit period (i.e. the period for which projections are made) and present value of terminal value. To work out the terminal value cash flows, explicit period's last year's gross cash flow is taken as base and an appropriate growth rate is applied to that.

While determining the growth rate for terminal value, one has to consider the length of the explicit period cash flow, long-term growth rate of the industry, etc.

From the gross cash flow, adjustment will have to be made for capital expenditure, incremental working capital requirement, tax payable, etc. to arrive at net cash flow for terminal value.

The cash flow so arrived has to be capitalised by applying following formula to arrive at Gross Terminal Value

$$\text{Gross Terminal Value} = \frac{\text{Net cash flow for terminal value}}{(\text{WACC} - \text{Growth Rate for Terminal Value})}$$

Discount rate of last year of explicit period has to be applied to arrive at present value of terminal value. If due to certain factors valuer is of the opinion that discount rate for explicit period and perpetuity should be different, he may choose two different discount rates.

Present value of terminal value = Gross terminal value * Discount factor for last year of explicit period

Calculation of Value for Equity Holders

Present value of cash flow for explicit period and present value of terminal value is added to arrive at the Gross Value of the business. This value is for all the fund providers. To arrive at the value for equity holders under firm approach of valuation following adjustments needs to be made:

Value for equity holders = Present Value of Cash Flows for explicit period + Present value of Terminal Value – Opening balance of loan as on valuation date + Opening Surplus cash not considered for working capital requirement + Realisable value of surplus assets, etc.

Conclusion

Although Discounted Cash flow Method is well accepted method in the recent times, it may not be suitable in certain cases. Take an example of an Investment Company – To have projections for the Investment Company is very difficult. How can one assume what dividend will be declared in future by the investee company? How can one assume, what will be profit or loss on sale of investment?

The valuer has to keep in mind the fact that the projections provided by the management will generally be growth oriented. Hardly you will come across the projections which has shown negative growth. However, in reality, businesses do go through the cycle of ups and down. Thus it is important for the valuer to understand the risk involved in achievement of particular projections and accordingly discount rate and growth rate for perpetuity needs to be chosen. In some cases the valuer may recommend a range of values and then it is left to the parties concerned to arrive at the transaction price.

CA Pinkesh Billimoria and Mr. Tejas Marfatia

Importance of Data Review (Including Future Projections) in Valuations

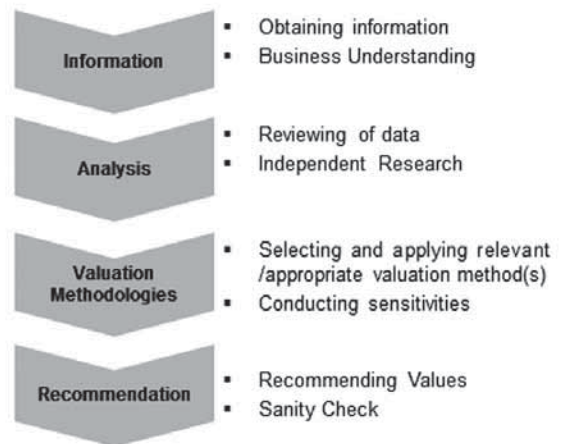
"Sometimes what counts can't be counted and what can be counted doesn't count"

- Albert Einstein

Valuation Analysis as ephemeral it may sound at times is both a science as well an art. Though quantitative in nature, the valuation methods require inputs that require quite a lot of subjective judgment and hence the quality of the information / data provided and an analysis and review of the same is of prime importance for arriving at a valuation conclusion.

The primary importance of review of the data provided for the valuation analysis is to arrive at a more reasoned conclusion as well as to mitigate any kind of a reputation risk, credibility risk, bad press risk, litigation risk and many more risks that one can only experience rather than write about or name them.

Before we look deep into the reasons for the importance of the review – let us take a brief look / recap at the steps in the valuation process to better evaluate and understand the importance of data and the consequent impact on the valuation.



If one looks at the process of valuation – the function of review of the data / information is the first and last cornerstone of the entire process. The review of the data is a continuous process for arriving at the valuation conclusion. Each step of the valuation process involves a certain level of review –

- review of what information would be required for the valuation
- review of how reasonable is the information provided in terms of independent research / information available in public domain

- review of what valuations methods to apply
- review of what the reasonable value should be and what the conclusion should be.

Let us step back and look at the definition of review. A quick Google search of the definition of review (the noun) – "a formal assessment of something with the intention of instituting change if necessary".

While having defined review – the process of valuation quite often also involves use of the word analysis as well. The search of definition of analysis (the noun) – "a detailed examination of the elements or structure of something: statistical analysis"

While the definition puts both review and analysis as two separate words the valuation is based on the art of review and science of analysis and hence one tends to generally use review / analysis as a combination of both the words review and analysis or are interchangeably used. The intent of analysis is to review the data for inconsistencies if any and to get a sense check on the reasonableness of the value or otherwise. Hence both the words review and analysis have been interchangeably used in the context of this article as well.

Why review ? One can always argue that the role of a valuer is to give value and not give an opinion on the quality of data / information provided. The review of data in a valuation analysis expands the definition as R (External) view of information/ data provided by the client or available in public domain.

The importance of review of the information cannot be undermined and is instinctive to our human evolution. Our personal upbringing, academics, professional experience all have made us professionals to question, review, criticise, analyse, critically analyse every bit of information provided to us. The Valuation Standards issued by American Society of Appraiser requires that the Valuer shall gather, analyze and adjust the relevant information necessary to perform a valuation appropriate to the nature or type of the engagement. Having established that review of data is required let us now address the pertinent question when does one review the information provided?

- at the time of acceptance of the valuation assignment; or
- at the time of the review or at the time of the execution of the valuation assignment; or
- at the time of the submission of valuation report or even thereafter.

The 1st time we as valuers review the data/ information provided is when there is an opportunity to provide the valuation service. The review at the time of accepting a valuation engagement is very high level in nature and only to understand what the subject matter of the valuation is, what is the client's requirement, whether we as valuers have the necessary knowledge and expertise to provide the valuation analysis. The review of the information has to be done at the time of acceptance of the valuation assignments – there are a lot of areas in business valuation which may require technical inputs and the lack of any kind of earlier experience would have to be a point of consideration – to determine how we can deliver and what we can deliver.

An initial review could be more of a flexibility/ feasibility study for the capabilities and expectations and to also lay down the ground for what kind of information is required to carry out the valuation analysis and provide the deliverable to suit the requirements of the clients.

While no preliminary information list can be exhaustive enough to determine the kind of information that may be required to do a valuation analysis, the attempt while requiring the initial information list should be ideally to capture the following key elements:

- Business / Commercial Aspects / Contractual Arrangements
- Financial Information Competitive Landscape
- Expected Business Opportunities
- SWOT
- Tax Related Information
- Non Operational Assets

An illustrative list of information for a manufacturing company could be as under Valuation date: 31st March 2013

I. Note on the business of the Company – including but not limited to the following:

a. An updated brief presentation covering details of the companies, product category/ products manufactured/ marketed / traded including those recently introduced or planned to be introduced, the geography to which it caters, brands / trademarks / intangibles used in business, basis of pricing, marketing strategy, personnel, distribution channels, office locations, details of headcount.

b. Discussion of past yearly performance trends including variance analysis (*vis-a-vis* budget) for the year ended 31st March 2013 including current scenario.

c. SWOT analysis.

d. Year wise quantitative details of products manufactured/traded, capacity utilisations, average prices realised and expected to be realized in the future etc. – 3 years ended 31st March 2013 and for the projected periods.

e. Details of any financial / technical collaboration agreements / tie ups with third parties (relevant copies / extracts of the agreement to be provided).

f. Current shareholding pattern of the Company.

g. Details of issues / transfers of securities made by the company / shareholders in past 3 years.

h. A note on industry in which the Company operates giving information about its characteristics, market size, future trends and prospects, key players, products' market share, expected growth rate, information on major players and their market share, and other relevant information, including analyst reports (to supplement our research).

II. Financial and other information

a. Annual reports of the Company (including directors' report, management discussion and analysis, notes to accounts) for the 3 years ended 31st March 2013 including details of extraordinary / non-recurring items of income and expenditure, if any.

b. Monthly / Quarterly profit and loss accounts of the Company for the last 12 months ended 31st March 2013 showing revenues from various business segments and giving details of material extraordinary / non-recurring items of income and expenditure.

c. Future profitability projections of the Company for a period covering a business cycle / Company reach a stable level of operations (at least 3 to 5 years) beginning 1st April 2013 (soft copy- linked MS Excel model):

   i. projected balance sheets,

   ii. profit and loss accounts,

   iii. proposed capital expenditure items including expansion capex,

   iv. assumptions on which these projections are based.

III. Other Information:

a. Details and current status of contingent liabilities and off balance-sheet exposures of the Company as of valuation date and the management view on the likely probability of these devolving.

b. Details of any major non-operating / idle / surplus assets, if any including a brief description, book value, Income Tax written down value, fair market / realisable values as of the Valuation date.

c. Current status of Income Tax assessments and tax computations for the year ended March 2013 and details of any benefits, in form of carry-forward loss and unabsorbed depreciation, if any as at the valuation date.

d. Transfer Pricing Studies and reports for the year ended 31st March 2012 or earlier.

e. Any other relevant information or any special factor that should be considered in the valuation.

A close look at the kind of information required enlists that most pieces of information required to do a valuation will require a broad level of review. For e.g. Financials have to reviewed / analysed to understand the trend in the income, identify non recurring items of income and expenditure, identify surplus / non operating assets of the business whose earning potential may not be adequately captured in the valuation of the operating business.

The implicit rule in valuation is "Take nothing at face value"– input determines output – "garbage in garbage out" - If poor data is collected, the valuation results would be equally poor. It is necessary, therefore, to collect accurate and appropriate data to achieve reasonable results. While uncertainty feeds on human biases - positive and negative, a review of data in terms of corroborative parameters mitigates to a certain extent the risk of over valuing / under valuing a business / assets/ equity.

A review of data is not a process of conflicting/ disagreeing on any and every information provided. The concept of "Trust but verify" applies to the present case as well. A review is not and does not necessarily constitute an audit or due diligence of the historical / projected information provided by the client but it is more a process of assimilation and understanding the information provided so as to make an informed consideration in the valuation analysis. It is only a process adopted by the valuer to assess the method that can be applied, the results that may emanate from such valuation and last but not the least determine the basis on which the valuer can provide his judgment. The level of review at times has to be seen whether there is a requirement at times to carry out a due diligence on the numbers provided or at times there is a requisite to involve a forensic expert. Nevertheless the valuer may not and is not required to carry out such analysis and should call upon some help from experts in the respective areas.

A review of the data does not mean that the valuer knows the business better than the client but it only bridges/ facilitates an understanding of the inherent business potential and pitfalls – the key value drivers and key risk areas, factors which critically affects the risk reward profile. The unspoken rule across valuation professionals is that the promoter / management knows his business best and the valuer is not countering his expertise credentials but at best exploring a possibility of basing a judgment on the business situation and implied valuation.

The valuer's role of review constitutes the following pieces:

- Evaluation of data provided through discussion and analysis.
- Broad review of management estimates in terms of public domain information.
- Discussions on the data provided with management.

However, it is important for the valuer to practice the "sufficiency of information" rule— once you believe you have enough information, stop the review / analysis, and move on with the overall valuation process. The old adage of don't miss the forest for the trees well applies to a valuer preparing to start a valuation. Hence the review should be more from a financial and business analysis perspective as compared to a accounting perspective.

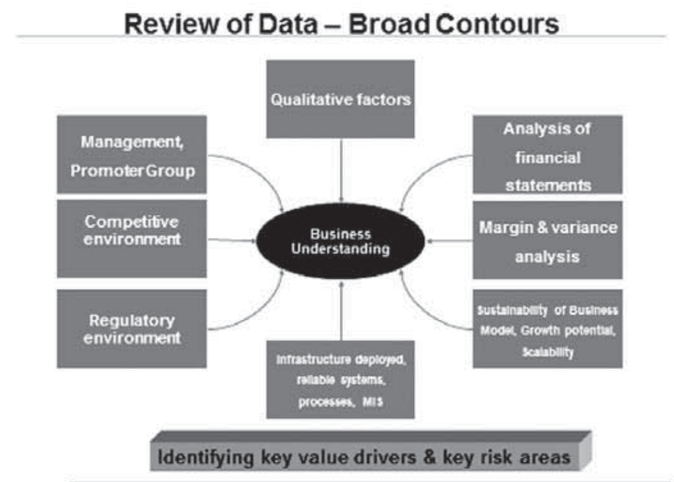
The nature of the business activity definitely calls for a review of the data provided, for e.g. a lot of businesses are either under regulatory controls – such as banks, NBFCs, Insurance, Pharmaceutical companies, Fertilizers etc. or commercial arrangements or have to meet certain requirements from a global parent.

For e.g. in the case of a road project - the limited life period of the project not only determines the method to be applied but also lays down the contour for the returns / information / assumption of the business of the business beyond the contractual arrangements. Some businesses like media / financial services / have limited period contracts with extension clauses available. Accordingly if one was to consider any income and thereafter the value attributable to such income, a valuer ought to factor in the risk of non-renewal of such limited life contracts.

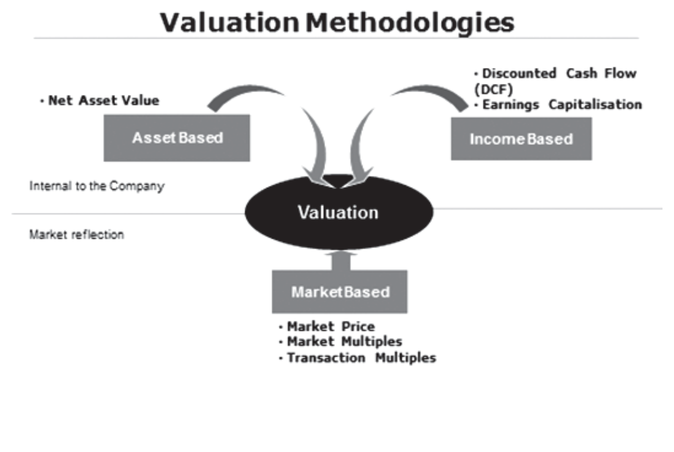
Further, in recent times the valuation of power companies is tightly affected by the impact of coal price increases and the consequent pass through may not be available then the shortfall would affect the valuation and on prudent grounds we would as valuers review the terms of the Bid/Power purchase agreement to understand the management rationale.

A review of the valuation / business assumptions / data for the valuation will be very helpful in cases when the businesses that are being valued are cyclical or seasonal in nature. A review of such business is very essential for deciding what basis can be considered in the valuation as what method do we apply to mitigate any risk for getting the value – over or under – as the valuation at the end of a business cycle and valuation at a beginning of a business cycle have far different assumptions and far different valuation conclusions for the same business.

Having stated the importance of review one also needs to see how to do the review of the data. The implied golden rule in review is to assess the information – not audit them or remake them. Some of the following contours listed below could be applied to review the data provided.



While the importance of review is the key topic for the article the importance and the need for the review as well as the means of review is best explained through the valuation methodologies and approaches.



Asset based - Net Asset Value – Key points for review of data when applying the valuation methodologies.

- Surplus Asset
- Contingent Liabilities/Assets
- Replacement Cost/Realisable Value
- Appreciation in the valuation of the non operating/surplus assets/investments

Market based – Market Multiples and Transaction Multiples methods – Review of data is required for:

- Non-recurring items of income and expenditure
- Differences in multiples applied adjustments
- Impact of any contingent liabilities
- Effective tax rates
- Segment Analysis to determine which comparable sets to consider for each segment or the most dominant segment
- Further within the same industry or segment the operating models may be far different – entrepreneurial models vs cost plus models
- Adjustment to the comparable companies multiples/comparable companies transaction multiples for factors such as control, non-listing, size, margins, growth, business dynamics surplus / operating assets not correctly captured in the earnings potential valuation.

Income based - DCF – Review of forecasts / projected working results is extremely critical as this goes to determine the value of the company/ business. The assumptions used should be central to any review in case of a DCF valuation. Where does one look for while reviewing the underlying assumptions for the projections ?

- Historical information on the companies
- Tax/Regulatory/Transfer Pricing requirements and compliances
- Market/industry/competition information
- Macro-Economic factors
- Business/Commercial/Contractual arrangements
- Vision statements of global companies

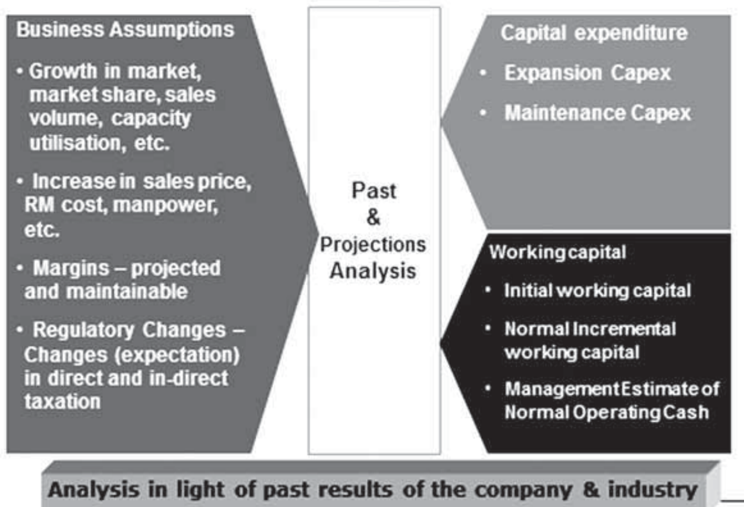
While it is easy to review the assumptions based on commercial/contractual arrangements there are certain open items such as inflation rates/ interest rates, exchange rates which would have to be considered based on macroeconomic factors, including estimates (e.g. currency forecasts from Bloomberg) and even GAAP requirements with respect to the projections.

Only if the value has reviewed the information then only one can consider carrying out any sensitivity to the projections and the resultant valuations due to changes in income expense and profitability. Sensitivity Analysis is a valuer's key counter for a lot of business valuations particularly valuations of new business ventures / fledging businesses / business where substantial investment and growth is expected in the projections.

A review of the margins past and projected is necessary to consider the maintainable level of earnings for comparable companies multiple based valuation as well as for the reasonableness of the margins projected that will have a direct impact on the valuation.

A review of any information can be done in 2 ways.

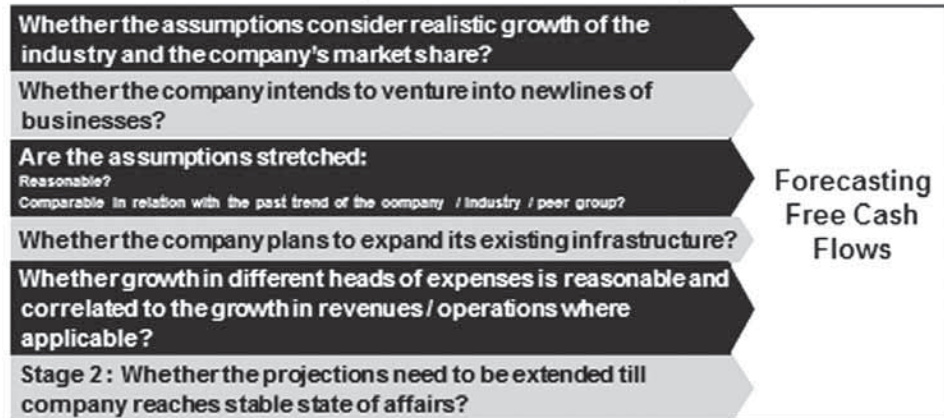
- in terms of historical information of the company.
- in terms of competitive landscape/ industry scenarios.



A review can address many open avenues as well as facilitate the subjective assessment of the factors affecting the valuation and help take a judgment call.

While from a valuers perspective the review of valuation data is always necessary for those readers who sit on the other side of the table as clients our suggestion would be to consider the entire exercise as a means of bettering the entire outlook of the subject matter of the valuation. A review helps to lead credibility to the business assertion. A review also helps provide adequate reasoning any observations issued by regulatory authorities in the near future. In many cases the heart of good valuation at times is a good forecast, and the quality and reliability of the forecast is contingent upon the quality and reliability of data used to support it. So the more relevant data a valuer gets, the more accurate would be the valuer's judgment.

Hence review/analysis is very necessary and a pre requisite for any valuation analysis. A review of the data of the past gives an insight into the financial strength of the business to be valued. A review of the assumptions/estimates used in the preparation of the business plan is a step to address the high risk of uncertainty that always creeps into any valuation analysis.



While the importance of review in valuation carries an outside risk of misjudgment, typical valuation procedure does always provide an opportunity of review of the data provided and hence a risk mitigation plan is always possible.

ABC LIMITED

INR Million

	FY 09	FY 10	FY 11	FY 12	FY 13
Profit & Loss Accounts					
Sales Units (Mio units)	37	38	36	33	32
Sales Price (INR per Unit)	72	97	118	121	119
Revenue	2,700	3,700	4,200	4,000	3,800
Reported EBIDTA	300	600	1,000	700	400
Reported PAT	100	300	700	300	75
Margins (%)					
EBIDTA	11.1%	16.2%	23.8%	17.5%	10.5%
PAT	3.7%	8.1%	16.7%	7.5%	2.0%

A high level observation indicates that the company ABC is operating on a different path as regards the industry.

While the revenues and earnings in the industry are increasing at a certain rate the same is not the case for ABC which has shown an uneven trend in revenue and a more declining trend in earnings.

INDUSTRY DATA

INR Million

	FY 09	FY 10	FY 11	FY 12	FY 13
Profit & Loss Accounts					
Sales Units (Mio units)	430	450	500	550	600
Sales Price (INR per Unit)	70	103	116	132	133
Revenue	30,000	46,500	58,125	72,656	79,922
Reported EBIDTA	3,000	8,800	10,500	13,750	15,000
Reported PAT	1,000	4,000	6,000	6,500	7,000
Margins (%)					
EBIDTA	10.0%	18.9%	18.1%	18.9%	18.8%
Reported PAT	3.3%	8.6%	10.3%	8.9%	8.8%

Post the data review one can observe that there were certain adjustments from a valuation perspective which may completely change the views on the operations of the company / comparison to industry and ultimately the valuation conclusion.

ADJUSTED FINANCIALS FOR ABC POST REVIEW OF DATA

INR Million

	FY 09	FY 10	FY 11	FY 12	FY 13
Profit & Loss Accounts					
Sales Units (Mio units)	37	38	36	33	32
Sales Price (INR per Unit)	64	89	118	112	119
Revenue	2,400	3,400	4,200	3,700	3,800
Adjusted EBIDTA	200	500	900	600	700
Adjusted PAT	75	275	675	275	300
Margins (%)					
EBIDTA	8.3%	14.7%	21.4%	16.2%	18.4%
PAT	3.1%	8.1%	16.1%	7.4%	7.9%

Further the above analysis can also help to review projections in terms of industry standards as generally information in public domain is available on the industry and not only a particular company.

The views expressed in this article are personal views of the authors.

CA. Vikarth Kumar

Engagement Letter, Management Representations and Independent Valuation Reports

Economic growth and globalisation has led to an increased interest in, and demand for valuations by stakeholders, of their investments, or potential investments or divestments. As a result of this, there has been increased importance towards standardisation in valuation procedures and methodologies followed by valuation experts. Valuations of businesses, business ownership interests, securities, assets, both tangible and intangible, may be performed for a number of purposes such as transactions, litigations, financial reporting and tax compliance, and for an enterprise's internal purposes such as financial or strategic planning.

A valuation engagement involves communication between the valuer and the client at various stages, which is evidenced in certain key documents such as an engagement letter, management representation letter and valuation reports. In simple words, an engagement letter is a contract between the valuer and the party engaging the valuer and outlines the terms and conditions within which an engagement is carried out. A management representation letter is a confirmation the client provides to the valuer with respect to the information or explanation that has been made available or provided during the course of the valuation engagement. The valuation report is the deliverable provided by the valuer, and outlines the purpose, scope, methodologies used and conclusion of value.

This article attempts to throw some light on these documents that form an integral part of a valuation engagement.

Engagement Letter

To start with, the Letter of Engagement/ Engagement Letter (EL), sent out before the commencement of any work, is the first step in any valuation engagement and shall clearly specify the nature, scope and limitations of services to be performed and the responsibilities of the parties. While the form and content of an EL might vary for each client and the type of valuation being performed, an EL would typically include:

- Valuer's understanding of the client's business or asset to be valued;
- Purpose and intended use of the valuation;
- Scope of work and the valuer's role in the engagement;
- Governing laws and regulations, e.g., FEMA, relevant Indian Accounting Standards, US GAAP or IFRS;
- Timeline of the engagement;
- Clauses regarding confidentiality with respect to the engagement, valuation

report and information regarding the client, or its business, business plans etc. which are confidential in nature;

- Management's responsibilities with respect to financial records and accuracy of information;
- Assumptions, limiting conditions and scope limitations; e.g., an EL may clearly specify that negotiation support is not a part of a transaction valuation engagement;
- Commercials including payment terms;
- General caveats including exclusions or scope limitations.

In addition to the above, the EL could also mention the date of valuation, intended users of the valuation report, limitation of liabilities and any additional conditions specific to the engagement.

In order to complete the engagement in a timely manner, an EL must include a clause that ensures the client is responsible for providing all the requisite information on time to complete the valuation exercise. Clauses with respect to the fees and payment terms may vary depending on the client, length of relationship, duration and type of engagement. One has to be careful when the engaging entity is outside India. Depending on what is mutually agreed upon between the client and valuer, appropriate clauses should be incorporated to include or exclude the valuer's name as an expert in the host country's regulatory filings as the risk of liability or damages can be huge. Additionally, the valuer must exercise caution with respect to the incidence and payment of taxes on fees. Similarly the EL must make it clear to the engaging party on certain clauses including seeking publicity on the engagement, limitation of liability on individual team members, definition (and sometimes limit) of out of pocket expenses, non solicitation of staff, reliance on external databases, etc.

In essence, having an EL with a clear scope and terms would reduce the possibility of any misinterpretation of the needs and expectations of either party.

Management Representation Letter

The next important piece of documentation is the Management Representation Letter (MRL). The valuer takes representation from the management regarding information that the client's management provides to the valuer for purposes of performing the valuation. This includes information provided through all modes of communication, including oral communication.

The content of the MRL depends on the nature and terms of the engagement and should be modified appropriately according to the requirements of the engagement. An MRL is usually signed by a senior member of the management responsible for providing information to carry out the valuation. It should be kept in mind that it is a good practice to issue the signed report only upon receipt of a signed MRL.

While the MRL may be standard in most cases one has to be careful not to miss out on certain common points like details of the historical, current and projected financial information, interest rates, details of surplus assets and contingent liabilities, details of accumulated losses, tax computations, and explanation provided on certain key assumptions in the financial model such as on strategic or expansion plans, documents, records and information. The management may also represent that it is not aware of any material misstatement of any fact or any other information that should be disclosed in the course of the valuation.

The MRL serves to avoid any misunderstanding or misrepresentation and also protects the valuer in case the valuation is challenged at a later stage by any party.

Valuation Report

Once the EL and MRL are in place, the most critical deliverable in the valuation process

is the valuation report, which encapsulates the result of valuation. The form of any particular report will depend on the nature of the engagement, its purpose, its findings and the needs of the decision-makers who receive and rely upon it. Reports should be carefully prepared, communicate the results and identify the information relied upon in the valuation process. The report should effectively communicate the methods considered and approaches used along with the reasoning for using a particular approach, as well as present the supporting documentation in a simple and concise manner. The valuer should indicate in the valuation report the restrictions on the use of the report (which may include restrictions on the users of the report, the uses of the report by such users, or both). The report should cover the standard of value such as Fair Market Value, Fair Value, Investment Value or Intrinsic Value; and the valuation premise such as liquidation or going concern.

The type of report issued by the valuer depends on various factors such as the type and purpose of engagement, the level of reporting detail agreed to between the two parties and users of the report. For instance, a report prepared under a governing law or regulation, would detail the relevant portions of the accounting standard or law under which the valuation has been carried out, along with its applicability in the engagement.

A detailed report for other engagements includes the following:

- Introduction to the business being valued, analysis of the subject entity and related non-financial information;
- Analysis of the industry to which the entity belongs;
- Financial statement/information analysis;
- Date of valuation;
- Valuation approaches and methods considered and used;
- Sensitivity analysis or scenario analysis if relevant;
- Conclusion of value;
- Caveats and scope limitations or exclusions;
- Appendices.

Certain kinds of engagements have a very limited scope and may not include all procedures required for a valuation engagement e.g. valuation based on only publicly available or market data. A report for such an engagement accordingly would only communicate the results of the engagement based on the scope agreed upon.

Conclusion

In conclusion, each of the key documents in a valuation engagement has a distinct purpose and responsibility attached. The valuer prepares the valuation report working within the scope and framework defined in the EL and the information provided in the MRL. Effective presentation of facts in these key documents can avoid confusion and lead to smooth delivery and client satisfaction. While we have attempted to present the standard clauses and contents of each document, these might vary depending on a lot of factors including but not limited to specific nature of the assignment, relationship with the client, valuer's judgment with respect to flexibility on certain clauses.

CA Gautam Nayak & CA Vishesh Sangoi

Regulatory Aspects of Valuations (Part-I – Direct Taxes)

Under direct tax laws, wealth tax is chargeable only on assets included in the definition of "assets" u/s.2(ea) of the Wealth Tax Act, 1957. Shares and securities are not assets included in the definition of "assets", and are therefore not liable to wealth tax. The question of valuation of such assets therefore does not arise under the Wealth Tax Act.

So far as income tax is concerned, section 56(2)(vii) read with section 2(24)(xv) charges to tax as "income from Other Sources", in the case of an individual or an HUF, the value of certain specified assets exceeding ` 50,000 received without consideration, or for consideration less than the fair market value. The list of such specified assets includes shares and securities. Similarly, section 56(2)(viia) read with section 2(24)(xv) seeks to tax the value of shares of a company in which the public are not substantially interested received without consideration, or for consideration less than fair market value, by a partnership firm or a company in which the public are not substantially interested. Section 56(2)(viib) applies to a case where a company, not being a company in which the public are substantially interested, receives consideration from a resident for issue of shares at a premium, and read with section 2(24)(xvi), taxes the excess consideration received over the fair market value of such shares. Therefore, for the purposes of sections 56(2)(vii), (viia) and (viib), the issue of determining the fair market valuation of shares and securities does arise. Rules 11U and 11UA lay down the methodology for valuation of shares and securities for this purpose.

It may be noted that section 56(2)(vii) applies to all shares and securities, including shares of listed companies and all types of securities, whereas sections 56(2)(viia) and (viib) apply only to shares of a company in which the public are not substantially interested, and not to listed shares or other securities.

Rule 11UA deals with the determination of fair market value (FMV) for the purpose of section 56 and Rule 11U defines certain terms used in Rule 11UA. While Rule 11UA had applied to sections 56(2)(vii) and 56(2)(viia), its applicability to section 56(2)(viib), which was later inserted by the Finance Act, 2012, was not certain. Rule 11UA of the Rules has been specifically amended to cover valuation of unquoted equity shares for the purpose of section 56(2)(viib) of the Act. The Central Board of Direct Taxes ('CBDT') has issued Notification No. 52/2012 on 29th November, 2012 amending Rules 11U and 11UA of the Income Tax Rules, 1962, by inserting sub-rule (2) and amending clause (c) of sub-rule (1).

Rule 11UA deals with valuation of all assets specified u/s. 56(2)(vii), (viia) and (viib), and not

just shares and securities. Sub-rule (1) applies to clauses (vii) and (viia) of section 56(2), whereas sub-rule (2) applies for the purposes of section 56(2)(viib).

Clause (c) of Sub-rule (1) of Rule 11UA deals with valuation of shares and securities for the purposes of sections 56(2)(vii) and 56(2)(viia) wherein an assessee (individual, HUF, partnership firm or company in which public is not substantially interested) is in receipt of shares or securities without consideration or for a consideration lower than FMV.

These provisions can be summarised below:

- **Valuation of Quoted Shares & Securities**

Particulars	Basis for determination of FMV
If quoted shares and securities are received by way of transaction carried out through any Recognised Stock Exchange (RSE)	Transaction value recorded in such RSE
If quoted shares and securities are received by way of transaction carried out other than through any RSE	Lowest price quoted on any RSE on the valuation date In case there is no trading on the valuation date, then FMV will be the lowest price on the date immediately preceding the valuation date when trading happened

- **Valuation of Unquoted Shares and securities**

Particulars	Basis for determination of FMV
Unquoted Equity Shares	Value as per balance sheet (including notes thereto) on the valuation date in terms of the following formula: $\frac{(A - L) \times (PV)}{(PE)}$ Where, A = Book value of assets in the balance sheet less (i) TDS or TCS or advance tax as reduced by Income Tax Refund (ii) Unamortised amount of deferred expenditure which does not represent value of any asset L= Book value of liabilities in balance sheet Less (i) Paid-up equity capital (ii) Amount set aside for undeclared dividend

	(iii) Reserves and surplus other than set apart for depreciation (iv) Provision for tax other than TDS or TCS or Advance Tax reduced by Income Tax Refund to the extent of tax payable with reference to book profits in accordance with law applicable thereto (v) Provision for meeting unascertained liabilities (vi) Contingent liabilities other than Arrears of Dividend in respect of Cumulative Preference shares PE = Total amount of paid-up equity share capital PV = Paid-up value of such equity shares received

- **Valuation of Unquoted Shares other than Equity Shares**

Particulars	Basis for determination of FMV
Unquoted shares and securities other than equity shares in an unlisted company	Price it would fetch if sold in open market on the valuation date and the assessee is required to obtain a report from the Merchant Banker or a Chartered Accountant in support of the FMV

Sub-rule (2) of Rule 11UA of the Rules deals with valuation of shares in respect of shares and securities of a company in which the public are not substantially received by a similar company, which falls under the purview of section 56(2)(viib). The provisions of this rule, which provides for two alternative methods of valuation, can be summarised as under:

- **Valuation of Unquoted Shares**

Particulars	Basis for determination of FMV
Unquoted Equity Shares	Value as per balance sheet (including notes thereto) on the valuation date in terms of the following formula: $\frac{(A - L) \times (PV)}{(PE)}$ Where, A = Book value of assets in the balance sheet less (i) TDS or TCS or advance tax as reduced by Income Tax Refund (ii) Unamortised amount of deferred expenditure which does not represent value of any asset

<table>
<tr><td></td><td>L= Book value of liabilities in balance sheet

Less

(i) Paid-up equity capital

(ii) Amount set aside for undeclared dividend

(iii) Reserves and surplus other than set apart for depreciation

(iv) Provision for tax other than TDS or TCS or Advance Tax reduced by Income tax Refund to the extent of tax payable with reference to book profits in accordance with law applicable thereto

(v) Provision for meeting unascertained liabilities

(vi) Contingent liabilities other than Arrears of Dividend in respect of Cumulative Preference shares

PE = Total amount of paid-up equity share capital

PV = Paid-up value of such equity shares received</td></tr>
<tr><td>Unquoted Equity Shares</td><td>FMV as determined by a merchant broker or an accountant as per the Discounted Free Cash Flow method.</td></tr>
</table>

Certain terms as defined in Rule 11U are defined differently for the purposes of sub-rule (1) and for the purposes of sub-rule (2). These differences are as under:

For Sub-rule (1) of Rule 11UA	For Sub-rule (2) of Rule 11UA
Balance sheet means the balance sheet of the company (including notes to and forming part of accounts) as drawn up on valuation date and audited by the statutory auditor under section 224 of the Companies Act, 1956.	**Balance sheet** means the balance sheet of the company (including notes to and forming part of accounts) as drawn up on valuation date and audited by the statutory auditor under section 224 of the Companies Act, 1956. Where balance sheet not drawn upon valuation date, the balance sheet drawn up on a date immediately preceding the valuation of date which has been approved and adopted in the AGM of the company.
Accountant means a Chartered Accountant within the meaning of The Chartered Accountants Act, 1949 and includes, in relation to any state, any person by virtue of the provisions of sub-section (2) of section 226 of the Companies Act, 1956 is entitled to be appointed to act as an auditor of companies registered in that State.	**Accountant** means a fellow of the Institute of Chartered Accountants of India within the meaning of the Chartered Accountants Act, 1949 who is not appointed by the company as an auditor under section 44AB of the Act or under section.

From this, it can be seen that the method of valuation of unlisted equity shares is primarily that of book value (break-up value) for the purposes of clauses (vii) and (viia) of section 56(2), while DCF method is also permissible for the purposes of clause (viib) of section 56(2).

Some Issues

Some of the issues which arise for consideration in respect of such valuation rules are discussed below.

1. Can Discounted Cash Flow Method of valuation be followed for the purposes of sections 56(2)(vii) and 56(2)(viia)?

From rule 11UA, it is clear that only the break-up value method can be followed for purposes of sections 56(2)(vii) and 56(2)(viia), while either break-up value method or DCF method can be followed for purposes of section 56(2)(viib).

2. Can yield method of valuation be adopted for running companies, instead of the break-up value method?

In this regard, the observations of the Supreme Court in the case of *Bharat Hari Singhania v CWT 207 ITR 1*, in the context of Wealth-tax Act, 1957 are relevant:

"If the rule is good and valid, it has to be followed in each and every case. It is not a matter of choice or option. The rule-making authority has prescribed only one method for valuing the unquoted equity shares. If this method were not to be followed, there is no other method prescribed by the rules.

Where there is a rule prescribing the manner in which a particular property has to be valued, the authorities under the Act have to follow it. They cannot devise their own ways and means for valuing the assets. Thus, rule 1D has to be followed in every case where unquoted equity shares of a company (other than Investment Company or a managing agency company) have to be valued."

On a conjoint reading of Rule 11UA and the above judicial ruling, it can be inferred that only the methods of valuation prescribed by Rule 11UA can be adopted for valuation of shares of any company, whether a running business or not. Since yield method of valuation is not prescribed by Rule 11UA, it cannot be adopted.

3. In case of listed shares, should transaction costs, such as brokerage, STT, service tax, stock exchange charges, etc. be included for the purposes of valuation?

The rule requires consideration of value recorded in the stock exchange. Such value does not include such transaction costs, though such transaction costs necessarily have to be incurred if shares or securities are acquired on the stock exchange.

4. In case of unlisted shares and securities other than equity shares, an accountant or merchant banker's report is required. Is the accountant or merchant banker required to follow any specific method? Can an Assessing Officer challenge the method of valuation adopted by the accountant or merchant banker?

There is no specific method prescribed for valuation by the accountant or merchant banker. He can therefore choose to follow any method of valuation, which is a recognised method and which is appropriate to the security being valued. The method of valuation can be challenged by the Assessing Officer only if it is not a recognised method of valuation appropriate for the particular type of security being valued.

5. Sub-rule (1) requires a balance sheet on the valuation date audited by the statutory auditor to be taken for valuation purposes of unlisted shares, unlike sub-rule (2) which permits use of the last Balance Sheet adopted by the AGM. Does this mean that audited accounts have to be prepared on each date that there is a transfer of shares

by a shareholder? What would be the relevant date – the date of lodgement of shares for transfer with the company by the purchaser, the date of approval of transfer of shares by the directors or the date entered on the transfer form as the date of execution of the transfer?

While it is true that sub-rule (1) refers to the audited balance sheet as on the valuation date, and the valuation date is defined in rule 11U as the date on which the property or consideration, as the case may be, is received by the assessee, it is impracticable and impossible to expect a company (even a private limited company) to get its accounts audited on each date that there is a transfer of its shares. In this regard, the observations of the Madras High Court in the case of *CWT vs. S Ram 147 ITR 278*, in the context of the Wealth-tax Act, 1957 are relevant:

"where a day or two separated the date of the gift from the date of the balance-sheet, it would be an unnecessary exercise of one's labour not to take note of the nearest balance-sheet, but to go upon some other laboured valuation of the company's assets involving effort and time. In all these cases of valuation of unquoted shares, however, the true principle is that if it were possible to draw up a precise balance-sheet as on the date of the gift that would afford quite an accurate basis and an ideal solution. But since the valuation question arises only in a shareholder's assessment, neither the shareholder nor the Department can expect the staff and accountants of the company to oblige them by meticulously drawing up a balance-sheet as on the date of the gift even assuming that the drawing up of a balance-sheet on that date would be feasible or is capable of being done in a correct manner, after a passage of time. In the absence of the facility of drawing up a balance-sheet precisely on the date of the gift, the next best thing, both for the assessee who is the holder of the unquoted shares and the Department, which is charged with the duty of evaluating the market value of the shares, not to speak of the company itself, is to take the balance-sheets falling both before and after the date of the gift and arrive, as near as may be, at the break-up value of the assets and liabilities of the company as on the date of the gift on a time basis, or on some other basis. …….We cannot be dogmatic about taking, as the basis, either the balance-sheet which falls before or the balance-sheet which falls after the date of the gift. We have to take into account both."

Therefore, the better view is that the company need not get the accounts audited on the date of transfer of the shares, but the transferee of the shares can work out the estimated fair market value of the shares on the date of purchase, by taking the audited accounts of the earlier year and the subsequent year into consideration.

6. **Whether provision for meeting liabilities, other than ascertained liabilities, would include provisions for gratuity, leave encashment, warranty costs, etc?**

As held by the Supreme Court in the cases of *Metal Box Company of India vs. Their Workmen 73 ITR 53 and Bharat Earth Movers vs. CIT 245 ITR 428*, provision for gratuity and provision for leave encashment are ascertained liabilities, though they may not be allowable as deductions under specific provisions of the Income Tax Act. As held by the Supreme Court in *Rotork Controls India P. Ltd. vs. CIT 314 ITR 62*, where the provision for warranty was made on a scientific basis, the assessee had a present obligation as a result of past events resulting in an outflow of resources and a reliable estimate could be made of the amount of the obligation. Therefore, the assessee had incurred a liability. Such provisions would therefore not be regarded as contingent liabilities.

7. **Contingent Liabilities are not to be treated as liabilities under rule 11UA. AS 29 requires provision of liability for an obligation, if it is a present obligation, it is probable that an outflow of resources will be likely to settle the obligation and a reliable estimate can be made of the obligation. Would such a liability be treated as a contingent liability?**

"Contingent Liability" has been defined in AS 29 as:

(a) a possible obligation that arises from past events and the existence of which will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the enterprise; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) a reliable estimate of the amount of the obligation cannot be made."

From the above definition, it is therefore clear that a present obligation involving probable outflow of economic resources, where a reliable estimate can be made is not a contingent liability. The accounting concept of contingent liability would apply equally for tax purposes. Therefore, such a liability is not required to be ignored while taking the figure of liabilities.

As held by the Supreme Court in the case of *Bharat Earth Movers vs. CIT 245 ITR 428*, "If a business liability has definitely arisen in the accounting year, the deduction should be allowed although the liability may have to be quantified and discharged at a future date. *What should be certain is the incurring of the liability. It should also be capable of being estimated with reasonable certainty though the actual quantification may not be possible. If these requirements are satisfied the liability is not a contingent one. The liability is in* praesenti *though it will be discharged at a future date. It does not make any difference if the future date on which the liability shall have to be discharged is not certain.*"

8. Advance tax, TDS and TCS, other than claim of refund of tax is required to be reduced from the gross assets under the break-up value method. Is MAT credit also required to be reduced from the assets as well as from the provision for taxation?

MAT credit is similar to an advance payment of taxes, as held by the Supreme Court in the case of *CIT vs. Tulsyan NEC Ltd 330 ITR 226.* It may therefore be possible to claim that MAT credit is also to be reduced from the gross assets, while computing the break-up value. In any case however, it should not make a difference to the computation, as the provision for taxation which is to be reduced from the liabilities, is also to be reduced by a similar amount.

9. Is any adjustment required for deferred tax assets or deferred tax liability while doing the valuation?

It has been clearly mentioned in the break-up value method formula that 'A' (Assets) stands for book value of the assets in the balance-sheet as reduced by any amount of tax paid as deduction or collection at source or as advance tax payment as reduced by the amount of tax claimed as refund under the Income-tax Act and any amount shown in the balance-sheet as asset including the unamortised amount of deferred expenditure which does not represent the value of any asset.

From the above, it can be seen that deferred tax asset is not required to be deducted from the value of assets, as deferred tax asset is not an advance payment of tax. Deferred tax liability, though possibility a provision for taxation, is not in the nature of reserve or unascertained liability, as held by the Tribunal in the case of *ACIT vs. Balarampur Chini Mills Ltd. 109 ITD 146.* However, the provision for taxation is deductible (over and above advance tax and TDS/TCS) only to the extent of tax payable with reference to the book profits. It is arguable that deferred tax liability is a provision with reference to the book profits, since such a liability arises on account of timing differences in computation of taxable income *vis-à-vis* book profits. It may therefore be possible to claim that deferred tax liability is a deductible liability in computing the break-up value.

10. In computing the value of shares under the break-up value method, is any adjustment required for revalued assets?

As per the break-up value method formula prescribed by Rule 11UA, 'A' (Assets) stands for book value of assets in the balance sheet as reduced by various items.

The observations of Bombay High Court in the case of *CWT vs. G.M. Abhayankar HUF 214 ITR 269* are relevant in this regard. The court noted:

"Rule 1D of the Wealth-tax Rules, 1957, prescribes the manner of valuation of unquoted equity shares of companies other than an investment company or a managing agency company. The basis of valuation of the market value of a share is "the value" of all the assets of the company "shown in the balance-sheet". It is from such value that the "value of all the liabilities shown in the balance-sheet" has to be deducted. Rule 1D provides in most clear and unambiguous terms that the value of the assets shown in the balance-sheet alone has to be taken into consideration for the purpose of valuation of shares. The expression "shown" means "actually shown". It cannot be construed as "could have been shown".

The language of rule 11UA is similar, and uses the term "book value of assets". This term has not been defined in rule 11U, and therefore would have its normal meaning. To determine FMV of unquoted shares and securities, 'book value of assets in the balance sheet', which includes value of assets disclosed at revalued figures, alone needs to be considered.

However, while calculating the 'L' (liabilities) as per the break-up value method formula, one has to exclude reserves and surplus, by whatever name called, which includes the revaluation reserve created while revaluing the assets. Therefore, the break-up value would include the amount of revaluation.

11. Is any adjustment permissible for non-marketability of shares of a private limited company, in computing the valuation under the break-up value method?

As observed by the Supreme Court in the case of *Bharat Hari Singhania vs. CWT 207 ITR 1*:

"Rule 1D has to be followed in valuing each and every case of unquoted equity shares of a company (other than an investment company or a managing agency company). It is not a matter of choice or option. The rule-making authority has prescribed only one method for valuing the unquoted equity shares. If this method were not to be followed, there is no other method prescribed by the rules."

The formula under the rule does not prescribe any adjustment for non-marketability of shares of a private limited company. Therefore, adjustments are not permissible for non-marketability of shares of a private limited company under the break-up value method.

12. Can an Assessing Officer make an adjustment to the DCF valuation certified by a merchant banker or a Chartered Accountant?

The purpose of certification of DCF valuation by a merchant banker or a chartered accountant is to ensure that the valuation is fair and reasonable, and on the basis of established valuation methodologies. Such valuation is by an expert on the subject, which an assessing officer is not expected to be. The rule provides that such valuation shall be the fair market value for the purposes of the section. An assessing officer therefore cannot normally make any adjustment to such valuation. However, obvious mistakes and blatant errors in the valuation may possibly be the subject matter of dispute by the assessing officer.

CA Anup P. Shah

Regulatory Aspects of Valuation – II (FEMA and SEBI)

I. Introduction

"Everything is worth what its purchaser will pay for it."

– Publilus Syrus' Maxim No. 847

In *Gold Coast Selection Trust Ltd. vs. Humphrey, 17 ITR Suppl 19 (HL),* the Court held that 'valuation is not an exact science. Mathematical certainty is not demanded nor is it possible.' The "Technical Guide on Share Valuation" published by the Institute of Chartered Accountants of India (ICAI), states that the valuation of the shares of a company involves use of judgment, experience and knowledge. It should also be recognised that the method of valuation of shares would vary, depending on the purpose for which it is to be used. All this implies that valuation is a very subjective exercise based on highly objective data! However, what happens when the Law takes away some element of the valuer's judgment and requires him to follow certain methods and procedures? It could lead to certain interesting and novel situations which might not arise when the valuer has full discretion. Let us look at the requirements of valuation under two major statutes, the Regulations issued under the Foreign Exchange Management Act, 1999 (FEMA) and the Securities Exchange Board of India Act, 1992 (SEBI).

2. FEMA

2.1 The FEMA Regulations notified under the FEMA specify a host of valuation requirements for different purposes. It is interesting to note that in some cases, the valuation methodology has been mandatorily laid down whereas in other similar cases, it has been left to the discretion of the valuer. The reason for such a dichotomy is not clear. It is suggested that in all cases, the choice of the valuation method to be adopted should be left to the discretion of the valuer. Let us examine the valuation requirements under the FEMA Regulations.

2.2 FEMA (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000

These Regulations deal with Foreign Direct Investment (FDI) into India and the transfer of shares from or to a person resident outside India. These Regulations provide for numerous valuation requirements which have been explained below.

2.2.1 Issue of Equity Shares by an Indian Company to a Non-Resident

(a) Issue by Listed Companies

The shares can be issued at a price determined based on the valuation guidelines prescribed under the SEBI Regulations. Though not

specified, it should mean the Preferential Allotment Guidelines of the SEBI (ICDR) Regulations, 2009.

(b) Issue by Unlisted Companies

The shares must be issued at price not less than the fair value of shares determined as per the DCF Method by a Merchant Banker or a CA. In some cases, the DCF value gives a negative figure on account of heavy losses in the projection period. However, here, the requirements of s. 79 of the Companies Act, 1956 should be borne in mind. A company can issue shares at a discount to face value only if sanctioned by the Central Government u/s. 79. Thus, in all other cases, the minimum issue price must be the face value, even if the DCF value merits a lower figure.

These Guidelines don't apply to acquisition of securities by a SEBI registered Foreign Venture Capital Investor (FVCI) whether by way of public offer or private placement by the issuer. FVCIs can transact at a price which is mutually acceptable to the buyer and the seller.

In both the cases, the Auditor or a CA needs to certify the manner of arriving at the price. The above valuation methodologies are also applicable when Indian companies issue shares against conversion of External Commercial Borrowings / lump sum technical know-how fee / royalty, etc.

It may be noted that unlike in the case of companies, no valuation guidelines have been specified for FDI in an LLP or a Partnership Firm. One question which has often been raised is that do the valuation requirements apply to an issue of shares to a non-resident Indian on a non-repatriable basis under Schedule 4 of the Regulations? There is no express provision in Schedule 4 requiring a valuation and the valuation requirements have been laid down only under Schedule 1 and not under the main Regulations. Hence, it stands to reason that there should not be any valuation for an issue on a non-repatriable basis. However, it may be noted that a contrary view is also prevalent. Further, as per some reports, the RBI is proposing to do away with these distinctions since it feels that these Schedules are not mutually exclusive and often lead to regulatory arbitrage.

2.2.2 Issue of Compulsorily Convertible Preference Shares (CCPS) / Compulsorily Convertible Debentures (CCDs) by an Indian Company to a Non-Resident

(a) Issue by Listed Companies

The securities can be issued at price determined based on the valuation guidelines prescribed under the SEBI Regulations.

(b) Issue by Unlisted Companies

The securities can be issued at price not less than the fair value of shares determined by a Merchant Banker or a CA as per the DCF Method. The conversion formula has to be determined or fixed upfront. The price at the time of conversion should not be less than the fair value worked out at the time of issuance of these securities. Earlier, the consolidated FDI Policy earlier provided that the pricing of convertible instruments also should be determined upfront. This took away the flexibility and utility of convertible instruments. One of the main benefits of CCDs / CCPS is to provide an earn-out mechanism to the FDI Investor and the Investee Company, i.e., if the company performs as projected then the conversion takes place as projected, if it betters the projections then conversion is at a premium and if it is lower than projected then conversion is at a discount. Thus, there is a carrot for doing good in the form of lower promoter dilution and stick for doing bad in the form of higher stake to the investor. This is how Private Equity / FDI deals are structured internationally. Recognising the need for this, the FDI Policy was amended to permit convertibility. Now all that is required is that the formula should be determined upfront and whenever the conversion event is triggered, the conversion price should be greater than or equal to the DCF valuation of the instrument but at the time of their issuance.

An issue arises when the conversion is linked to certain uncertain events at a future date, how does one determine the number of equity shares? The correct way would be to calculate the equity shares on an as – if converted basis using the most likely assumptions.

In both the cases, the Auditor or a CA needs to certify the manner of arriving at the price.

2.2.3 Downstream Investment by an Indian company in another Indian company

Downstream investment means indirect foreign investment, by one Indian company, which is not owned and / or controlled by resident Indian entities, into another Indian company. The share investment, even in such a case, must comply with the valuation guidelines explained above for an FDI investment. Thus, the downstream is put on par with an FDI investment.

2.2.4 Rights Issue of Equity Shares by an Indian Company to a Non-Resident

(a) Issue by Listed Companies

The shares can be issued at a price determined by the Company.

(b) Issue by Unlisted Companies

The shares can be issued at price not less than the price at which the offer on rights basis is made to the resident shareholders.

2.2.5 Transfer / Sale of Shares by a Resident Indian to a Non-Resident

(a) Shares of Listed Companies

The shares can be transferred at a price not less than the price determined as per the Preferential Allotment Guidelines of the SEBI (ICDR) Regulations, 2009. The price should be certified by a Merchant Banker or a CA.

(b) Shares of Unlisted Companies

The shares can be transferred at price not less than the fair value of shares determined by a SEBI Registered Merchant Banker or a CA as per the DCF Method. Thus, the DCF value is the floor price for the transfer.

While considering the transfer price for sale from a resident to non-resident, the requirements of s. 56(2)(vii) / (viia) of the Income-tax Act and the FEMA Guidelines should be together considered. For instance, under FEMA the sale cannot be at lower than DCF value whereas under Income-tax, the purchase price must be at least at the book value of the share. Thus, the floor is the higher of the two prices.

These guidelines don't apply to purchase of securities by FVCIs, which can transact at a price which is mutually acceptable to the buyer and the seller.

2.2.6 Transfer / Sale of Shares by a Non-Resident to a Resident Indian

Transfer covers sale, buyback, reduction of capital. Thus, an exit to a private equity investor, buyout by the promoters, etc., would be covered within these Guidelines.

(a) Shares of Listed Companies

The shares can be transferred at a price not more than the price determined as per the Preferential Allotment Guidelines of the SEBI (ICDR) Regulations, 2009. The price should be certified by a Merchant Banker or a CA.

(b) Shares of Unlisted Companies

The shares can be transferred at price not more than the fair value of shares determined by a Merchant Banker or a CA as per the DCF Method. Thus, the DCF value is the ceiling for the transfer. It is quite common in Share Subscription Agreements for the promoters to give a guaranteed return to the private equity investor at a certain Internal Rate of Return (IRR). It should be noted that a fixed price or an IRR guarantee without considering the FEMA pricing Guidelines is not possible. For instance, in the case of DLF Assets Ltd., the RBI objected to DLF Ltd. giving a fixed price exit to DE

Shaw, USA when the FEMA valuation permitted a lower price. Thus, one should remember Contract Law basics, no one can contract to do anything contrary to the prevailing law or that all contracts are always subject to the law in force.

While considering the transfer price for sale from a non-resident to a resident, the requirements of s. 56(2)(vii)/(viia) of the Income-tax Act and the FEMA Guidelines should be together considered. For instance, under FEMA the sale cannot be at higher than DCF value whereas under Income-tax, the purchase price must be at least at the book value of the share. Thus, the tax valuation is the floor while the DCF value is the ceiling. Take a case of a buyout of an FDI investor by the promoter in a company where the projections show heavy losses and hence negative / negligible DCF value. If the promoter buys at lower than the book value, then they would end up paying tax u/s. 56(2)(vii)/(viia).

These guidelines don't apply to sale of securities by FVCIs which can transact at a price which is mutually acceptable to the buyer and the seller.

2.2.7 Pricing Guidelines Not Met

The RBI has permitted the transfers specified in paras 2.2.4 and 2.2.5 even in cases where the pricing guidelines are not met. However, the conditions to be satisfied for the same are as follows:

(a) The original and resultant investment comply with the extant FDI policy/ FEMA regulations;

(b) The pricing complies with the relevant SEBI regulations, such as IPO, Book building, block deals, delisting, exit, open offer and buy back;

(c) A CA's certificate to the effect that compliance with relevant SEBI regulations as indicated above is attached to the Form FC-TRS to be filed with the Authorised Dealer; and

(d) Reporting and other guidelines are complied with.

This amendment was made in 2011 because sometimes it was not possible to reconcile both the FEMA Guidelines and the SEBI Guidelines. For instance, consider the case of an open offer made by a non-resident under the SEBI Takeover Code. He would comply with the pricing guidelines specified under the Takeover Code but these may not be in compliance with those under FEMA. Hence, all open offers by non-residents required prior permission of the RBI. This held up the offers. Thus, now it has been provided that any transaction which is in compliance with pricing guidelines of SEBI Regulations can bypass the FEMA pricing guidelines. This is a welcome move.

2.2.8 Gift of Shares by or to a Person Resident Outside India

Certain persons resident outside India can gift shares or convertible debentures to other persons resident outside India residents on an automatic route. Since the gift of shares does not involve any consideration, no valuation is required for a gift of shares by a non-resident.

However, a gift of shares by a resident to a non-resident requires prior permission of the RBI. Further, the maximum value of the gift cannot exceed US$ 50,000 in a financial year. While applying to the RBI, a valuation report from a CA is to be submitted. The valuation of listed securities is to be done as per the SEBI Guidelines while in the case of unlisted securities as per the DCF method.

2.2.9 Issue for Consideration Other than Cash

Issue of Shares by SEZs against Import of Capital Goods

Units in Special Economic Zones (SEZs) can issue equity shares to non-residents against Import of Capital Goods. The valuation should be done by a Committee consisting of Development Commissioner and the appropriate

Customs officials. No valuation methodology has been prescribed.

Issue of Shares against Import of Capital Goods / Machinery / Equipment

This is allowed with Approval of the FIPB.

The import must be made by a resident in India under the extant FEMA and Foreign Trade Policies. Capital Goods/Machineries / Equipments should be independently valued, preferably by a third party independent valuer who is from the country of import. Documents of Customs Fair Valuation of such imports are also required.

2.2.10 DCF Method for FEMA Purposes – Discretion to Valuer

Elsewhere in this month's issue, the DCF method has been described in detail and hence, we need to go over the same again. However, since the DCF method is used for a variety of purposes, let us look at some concerns which one comes across under the FEMA Regulations while dealing with the same. While using the DCF method is mandatory in a variety of cases, the valuer does have discretion in some aspects of valuation:

(a) Selection of the explicit forecast period, i.e., the period for which projections should be made for the company. Ideally one business cycle of the company should be factored in the projections. However, it is quite common for managements to state that they are unable to prepare projections beyond three years since their business plans are for that duration. The valuer should apply his mind as to how he would like to use the DCF in such a scenario. CAs would be well advised to bear in mind the ICAI's Code of Ethics – they can participate in the preparation of financial forecasts so long as they do not vouch for the accuracy of the forecasts.

(b) Selection of the growth rate for working out the Terminal Value. For this purpose, the valuer can consider various facets, such as, key result areas of the company, compounded annual growth rate in revenue / EBITDA / profits before tax, etc.

(c) Method of working out the Terminal Value. Thus, it could be worked out as a Revenue Multiple or EBITDA Multiple or the generally used method of capitalising the Free Cash Flows at an appropriate rate. In some unique industries/companies, circumstances may be such that none of the tried and tested methods would work. The valuer should use his discretion in these cases and make an appropriate mention of the same in his Report.

For instance, consider the case of a Real Estate SPV in which a Foreign Private Equity Investor has invested. The project has been completed and sold-off. The Investor is now to be given an exit by way of a buyout by the Promoter. The price cannot exceed the DCF Valuation of the SPV. There would not be any Terminal Value for the Company in such a case. Whatever is earned by the Company during the project period may be assumed to be the value of the company, unless there are assets like Fixed assets/ Investments which can be liquidated and they can fetch more than their book value. An alternate way would be to consider the present value of the dividends, net of tax in the hands of the shareholders.

Similarly, consider a real estate SPV which has executed a perpetual lease of its project. How does one calculate the terminal value of the company since the net lease rentals may not be substantial to give a positive DCF value especially after considering the heavy upfront capital expenditure?

(d) Method of working out the discount rate. Whether the valuer selects a rate which

he feels is appropriate or he works it out on the basis of the Weighted Average Capital Cost, Capital Asset Pricing Model (CAPM), Dividend Yield of comparable stocks, etc., is his discretion. If the CAPM is used, then what beta to apply and how to find out the market risk premium are two important issues.

(e) The valuer should pay heed to whether the value worked out is the pre-money or the post-money valuation? Where the amount is already received by the company before the valuation date, then it should be deducted from the Enterprise Value to arrive at existing shareholder's value.

(f) How to deal with surplus cash is another area which should be considered.

(g) Valuing partly paid-up shares is another interesting issue. The resultant per share value arrived at by dividing the share holders' value by the total number of equity shares would be the value per share for fully paid shares. The value for partly paid shares would have to worked out by making adjustments for the outstanding calls.

One only hopes that these continue to remain in the domain of the valuer and the RBI does not come out with Guidelines on how to carry out a DCF Valuation!

2.2.11 DCF Method for FEMA Purposes – Issues for the Valuer

There are times when the insistence on selecting DCF method as the sole method can pose a challenge to the valuer. Some of the issues which a valuer could face, include the following:

(a) There are some industries where the DCF method is less appropriate. Even in such cases, the DCF method must be followed. For instance, while valuing an NBFC or a Bank, one may prefer to use the Price to Book Value/Net Asset Value Method. Businesses of IPO financing by NBFCs / Stock Brokers are heavily influenced by the peaks and valleys in the stock market. In such cases, it needs to be considered whether the management would be in a position to make reliable projections. It is well known in the world of finance that unless the projections are robust and realistic, DCF could end up being "garbage in garbage out". However, even in such cases, the valuer must stick to the method laid down.

(b) While valuing an Investment Holding Company, i.e., a company which has only one major asset which is shareholding in a listed / unlisted operating company, one may be tempted to value the company on a Net Asset Basis by substituting the market value of the investment. This method also draws support from "The Valuation of Company Shares and Businesses", 7th Edition, by M. S. Adamson, by the Law Book Company Ltd.

The company being primarily an Investment Company which does not have any substantial business activity, would making projections and a DCF thereof serve any purpose? In such a case, it needs to be considered whether a sum-of-total-parts approach would be appropriate?

(c) How does a minority share holder who is selling to or buying from a resident get access to the Company's projections? If he does not have projections, how would the valuer carry out a DCF valuation? Can he ask the management of a company to share their financial budgets and forecasts with him? Moreover, what if the minority who is not in management is at loggerheads with the majority and wants to exit by selling to a foreign investor. In such an event, would the majority oblige with the projections?

(d) One question which has been often raised is that is a DCF necessary for FDI in a start-up venture which has nothing but a business plan? Is a DCF not an empty formality in such a scenario? Here one can answer critics by stating any valuation methodology for a start-up would face the

same fate of uncertainty. Why single out DCF alone? The RBI has relaxed valuation norms in the case of subscription to the Memorandum of Association. Thus, if non-residents subscribe to the Memorandum, then the issue may be made at face value and need not comply with the DCF valuation.

(e) Under the current DCF Valuation Methodology, the Regulations do not expressly provide for a discount for lack of marketability. The erstwhile CCI Guidelines provided a 15% discount for the same. It is submitted that the Valuer should apply his own discretion in this matter.

(f) In a recent decision in the case of Zeppelin Mobile System GmbH [TS-146-ITAT-2013 (Del)], a German company sold its investment in an Indian company to a resident at a price of ` 390 per share. The valuation carried out under the RBI's Guidelines under FEMA pegged the value of the share at ` 400. Thus, the non-resident could sell its investment at ` 400 or lower. The AO imputed a capital gains of ` 10 in addition to the gains offered by the German company by stating that the RBI Guidelines were binding. The Tribunal rejected this finding and held that the RBI Guidelines on pricing of shares issued under FEMA regulations are relevant for remittance purposes only and are not binding for the Income-tax Act, 1961. Since the RBI's Guidelines have been issued specifically FEMA purposes, it is the FEMA alone authorities who are competent to take appropriate action against the assessee on breach of the Guidelines.

(g) In another recent decision in the case of Ascendas (India) (P) Ltd., [2013] 33 taxmann.com 295 (Chennai), it was held that in a case where an Indian company sold its shares in a closely-held Indian company to its foreign associate company, the DCF method could be used for ascertaining the arm's length price for transfer pricing purposes. Other methods prescribed u/s. 92C(1) of the Income-tax Act are inapplicable in such a case.

(h) One issue which arises is in case of a share transfer between two associated enterprises, can the fact that the transaction has received automatic approval under FEMA be considered to mean that it is also an arm's length price for Transfer Pricing? Two interesting and diametrically opposite decisions were rendered by the Mumbai ITAT within a span of a few days. Although these decisions were rendered in the context of royalty payment and transfer pricing, the ratio is applicable even in the case of share transfers. In M/s. ThyssenKrupp Industries India P Ltd., [2013] 33 taxmann.com 107 (Mum) the Mumbai Tribunal held that when the rate of royalty payment and fee for drawings etc. has been approved or deemed (under the auto route) to have been approved by the RBI, then such payment has to be considered at ALP. However, in an earlier case of SKOL Breweries Ltd. [2013] 29 taxmann.com 111 (Mum) the Mumbai Tribunal held that the FDI policy and prescribing the percentage of the royalty to the sales allowed under automatic route and cannot substitute as ALP to be determined under the provisions of the Act and Rules. FDI policy permitting certain percentage of payment of royalty is only for remittance of the amount in foreign exchange and therefore, such permission given in an entirely different context and purpose cannot be considered as relevant for determination of the ALP. It may be noted that both the decisions were rendered *per incuriam*, i.e., without reference to each other.

According to some reports, the RBI is considering allowing any internationally accepted valuation methodology rather than insisting upon the DCF alone. This would be a

very good move since it would permit the valuer to select a "horses for courses approach" rather an "one-size-fits-all approach".

2.3 FEMA (Transfer or Issue of any Foreign Security) Regulations, 2004

Unlike in the case of an FDI transaction, an overseas direct investment in a subsidiary / joint venture does not require a valuation to be done. Further, though the following outbound investment transactions require a valuation, no methodology has been prescribed for the same. Thus, the valuer can select, the DCF, Asset-based method, Price-Earnings Multiple, comparable transaction method or any other acceptable and appropriate method in these cases:

No.	Transaction	FEMA Requirement for Valuation
1.	Partial / Full acquisition of a foreign company, e.g., Apollo Tyres' acquisition of Cooper Tire and Rubber Inc., USA	Valuation of the shares of the foreign company by an Indian / foreign Merchant Banker, if investment > US $ 5 million and by a CA / CPA in all other cases. One wonders why such an artificial cap is kept? Is a CA/CPA valuation less reliable once the deal crosses $ 5 million?
2.	Investment by stock swap, i.e., Indian company acquiring a foreign company by issuing its shares as consideration to the foreign shareholders.	Valuation of the shares of the foreign company by an Indian / foreign merchant banker. Here a CA's valuation is not acceptable irrespective of the transaction size.
3.	Investment by ADR issue, i.e., Indian company acquiring a foreign company by issuing its ADRs / GDRs as consideration to the foreign share holders.	• Valuation of the shares of the foreign company by an Investment Banker if the shares are unlisted. • If the shares are listed then the valuation should be based on the monthly average price on any foreign stock exchange for 3 months preceeding the deal + any premium recommended by the Investment Banker in his Due Diligence Report. This is a bit strange. o Firstly, Investment Bankers don't carry out Due Diligences. That is usually done by a Lawyer and a CA. o Secondly, a Due Diligence Report never specifies the Premium to be paid. That normally comes out in a Valuation Report or an Information Memorandum.
4.	Sale of an unlisted foreign wholly owned subsidiary / joint venture by its Indian shareholder.	Valuation of the shares of the foreign JV / WOS by a CA / CPA. The sale should not be at a price less than the fair value of the shares based on the latest audited financial statements of the JV/ WOS. In this case, the Regulations specify some sort of valuation requirement. Thus, either a Net Asset Value or an Earnings Capitalisation Method may be considered.

3 SEBI

Next let us look at the valuation requirements specified under some of the Regulations issued under by the SEBI.

3.1 IPO Issue Pricing

(a) All companies are permitted to price their issues in consultation with the Lead Merchant Banker or through the book building process. For book building the floor price or the price band should be mentioned. In case of a band, the ceiling should not be more than 20% of the floor of the band, i.e., the range should be 20%. The cut-off price is fixed through a price discovery process.

(b) No Valuation Methodology is prescribed for the same. However, the basis for issue price, floor price or price band needs to be disclosed in the Prospectus and Advertisement for Public Issue and justified by the Issuer Company on the grounds of Qualitative Factors along with the following Quantitative Factors:

- EPS and Diluted EPS for last 3 years
- Price Earning Ratio on pre-issue basis
- Average Return on Networth in the last 3 years
- Minimum Return on Increased Networth to maintain pre-issue EPS
- Net Asset Value based on last Balance Sheet and post-issue
- Comparison of above Accounting Ratios of issuer with peers

3.2 Rights Issue Pricing

(a) All companies are permitted to freely price their rights issue.

(b) No Valuation Methodology is prescribed for the same.

3.3 Preferential Issue

(a) Shares are listed for 26 weeks or more as on the Relevant Date

The equity shares shall be allotted at a price which is not less than higher of the average of weekly high/low of closing prices during:

- o 26 weeks prior to the Relevant Date
- o 2 weeks prior to the Relevant Date

Relevant Date is defined as a period 30 days prior to the EGM date where the resolution u/s. 81(1A) is passed

(b) Shares are Listed for less than 26 weeks as on the Relevant Date

The equity shares shall be allotted at a price which is not less than higher of the following:

- o IPO Price or value arrived at under Scheme of Arrangement
- o Average of weekly high/low of closing prices during the period prior to the relevant date
- o Average of weekly high/low of closing prices during the 2 weeks prior to the relevant date

Relevant Date is defined as a period 30 days prior to the EGM date where the resolution u/s. 81(1A) is passed. The price shall be recomputed on completion of 26 weeks from the date of listing with reference to the average of the weekly high and low of the closing price during the 26 weeks. If such recomputed price is higher than the price of Preferential Allotment, then the difference shall be paid by the allottees to the Issuer Company.

(c) Preferential Allotment to QIBs not exceeding 5 in number

The equity shares shall be allotted at a price which is not less than the average of weekly high/low of closing prices during 2 weeks prior to the Relevant Date. Relevant Date is defined as a period 30 days prior to the EGM date where the resolution u/s. 81(1A) is passed.

(d) Shares arising out of Warrants/ FCD/PCD
Same as above.

(e) Consideration other than Cash
When the securities are issued on a preferential basis to promoters and related parties for consideration other than cash, then a valuation of the assets received in consideration shall be carried out by an independent qualified valuer, being a CA or a merchant banker. This valuation must be submitted to the stock exchange where the company is listed. In case the exchange is not satisfied with this valuation, then it may get the valuation redone from any other valuer.

(f) Private Placement by Unlisted Public Company
The Unlisted Public Companies (Preferential Allotment) Rules, 2003 issued u/s. 81(1A) of the Companies Act, 1956 deals with the preferential allotment of shares and convertible securities by unlisted public companies.

The Notice calling the Meeting to pass such an issue must disclose the price or price band at which the allotment is proposed and the relevant date on the basis of which price has been arrived at. Further, where Warrants are issued on a preferential basis with an option to apply for and get the shares allotted, the issuing company shall determine beforehand the price of the resultant shares.

3.4 Qualified Institutional Placements
The price of the equity shares shall not be less than the average of the weekly high and low of the closing prices during the two weeks preceding the relevant date. As regards the convertible securities, the price shall be determined pursuant to conversion or exchange taking the relevant date as decided while passing the special resolution. Partly paid-up eligible securities cannot be issued. The prices determined shall be subject to appropriate adjustments if the issuer makes bonus issue, rights issue, undertakes consolidation or sub-division, reclassification of shares, etc. The Issuer may offer a discount of up to 5% on the price so calculated for the QIP, provided shareholders approve the same.

3.5 Institutional Placement Programme
IPP can be made at free pricing either at a floor price or within a price band. No Valuation Methodology is prescribed for the same.
The eligible seller shall announce a floor price or price band at least one day prior to the opening of the IPP.

3.6 SEBI Takeover Regulations
Probably, no other corporate law statute is as concerned with valuation as the SEBI Takeover Regulations, 2011. This is because the objective of these Regulations is to ensure that the minority shareholders get a fair price for their shareholding. R. 8 of the Regulations deals with the Open Offer price, i.e., the price at which the Acquirer must acquire shares from the public share holders. While the Regulations are very complex, the provisions in this respect for a Direct Acquisition of Shares or Voting Rights or Control over Target Company may be briefly summarised as follows:

No.	Factor	Provision
1.	Offer Price	The offer price shall be the highest of, — (i) the highest negotiated price per share under the agreement attracting Public Announcement (“PA”); (ii) the volume-weighted average price paid/payable, by the Acquirer or persons acting in concert (“PACs”), during the 52 weeks immediately preceding the date of the PA;

		(iii) the highest price paid/payable, by the Acquirer/PACs, during the 26 weeks immediately preceding the date of the PA; (iv) the volume-weighted average market price for 60 trading days immediately preceding the PA date on the stock exchange where maximum trading volume is recorded during such period, provided such shares are frequently traded; (v) where the shares are infrequently traded, the price determined by the acquirer and the manager to the open offer taking into account valuation parameters including, book value, comparable trading multiples, and such other customary parameters. For this purpose, the SEBI may require valuation of the shares by an independent merchant banker other than the manager or an independent CA in practice having a minimum experience of 10 years.
2.	Date of making PA in case of an Acquirer triggering an open offer pursuant to a Preferential Allotment	Date on which the board of directors of the target authorises such preferential issue. This recent amendment has been made by the SEBI pursuant to the Diageo-United Spirits Deal where Diageo argued that the date should be the date of the Board Meeting and not the date of the EGM Resolution u/s. 81(1A) of the Companies Act. This is because once the Board approves the deal, the market price runs up by the time the EGM approves of the same.
3.	Date of making PA in case of an Acquirer triggering an open offer pursuant to a combination acquisition, e.g., purchase from promoters along with preferential allotment, market purchases, etc.	Date of first such acquisition, provided the acquirer discloses in the PA the details of the proposed subsequent acquisition.
4.	Any outstanding instruments convertible into shares of the target company at a specific price	The price at which such instruments are to be converted into shares, shall also be considered as a parameter.
5.	Control premium / non-compete fees	The price paid shall include any price paid/agreed to be paid in any form whatsoever, whether termed as control premium or as non-compete fees or otherwise.
6.	Acquisition by Acquirer/PACs of any shares/voting rights in target during the offer period, whether by subscription or purchase	If done at a price higher than the offer price, the offer price shall stand revised to the highest price paid or payable for any such acquisition.

7.	Corporate Actions, such as rights issue, bonus, stock consolidations and splits, payment of dividend, de-mergers and reduction of capital by Target	Price may be adjusted by Acquirer for corporate actions, if the record date falls prior to 3 working days before the commencement of the tendering period.
8.	Acquirer/PACs acquire shares of target during 26 weeks after the tendering period at a price higher than the offer price	Pay the difference between the highest acquisition price and the offer price, to all the share holders whose shares were accepted in the open offer, within 60 days from the date of such acquisition.
9.	If the open offer is subject to a minimum level of acceptances	Acquirer may indicate a lower price, which will not be less than the price determined above for acquiring all the acceptances despite the acceptance falling short of the indicated minimum level of acceptance, in the event the open offer does not receive the minimum acceptance.
10	Offer Price for Partly Paid-up Shares	Calculated as difference between the offer price and the amount due towards calls-in-arrears including calls remaining unpaid with interest, if any, thereon
11.	Offer price for equity shares carrying differential voting rights	Determined by Acquirer and manager to the open offer with full disclosure of justification for the price so determined.
12.	Any of the price parameters contained above not being in Indian rupees	Conversion of such amount into Indian rupees shall be effected at the exchange rate prevailing on the date preceding the PA date and the acquirer shall set out the source of such exchange rate.

Detailed and complex provisions have also been laid down for an Indirect Acquisition of shares, voting rights or control. Discussing these would require an Article by itself.

3.7 Buyback of Shares

It may be noted that the SEBI Buyback Regulations do not specify any pricing mechanism for determining the buyback price. Similarly, the Unlisted Public Company Buyback Rules, 1999 do not specify any pricing mechanism for determining the buyback price.

3.8 ESOP Guidelines

Under the SEBI ESOP Guidelines, 1999 the closing market price, prior to the date of the Board Meeting at which options are granted forms the basis with which the intrinsic value of the accounting hit is computed. Thus, if the grant price is less than this market price, then there is an accounting hit on the books of the company which is required to be amortised over the vesting period on a straight line basis. The company is free to fix any issue / exercise price subject to this accounting compensation recognition requirements. However, if a company follows the intrinsic value, then it must disclose the fair value of the options in the Directors' Report. The fair value is to be computed using an option-pricing model, such as, the Black-Scholes Model or a Binomial Model which considers the grant date, the exercise price, expected life of the option, market price, expected volatility in prices, dividend yield, risk-free rate of return. Thus, instead of merely comparing the market price with the exercise price it considers a host of other factors. The

Guidance Note on "Accounting for Employee Share-based Payments" issued by the ICAI also casts a similar requirement on all listed as well as unlisted companies. However, for unlisted companies since there is no market price as on the grant date, it requires that the value is determined by an independent valuer.

3.9 Delisting

The SEBI Delisting Regulations, 2009 govern the provisions pertaining to voluntary delisting of equity shares from a stock exchange by the promoter. Thus, the promoter buys out the public shareholding and gets the shares delisted. The promoter needs to fix the floor price. It shall not be less than:

(a) Where the equity shares are frequently traded, the higher of the average of the weekly high and low of the closing prices of the equity shares during the 26 weeks or 2 weeks preceding the date on which the Board Meeting taking up the delisting proposal was notified to the exchanges.

(b) Where the equity shares are infrequently traded, the floor price would be determined by the merchant banker considering the following factors:

- The highest price paid by the promoter during the 26 weeks period prior to the date on which the proposal was considered
- Other parameters, including return on net worth, book value, EPS, price earning multiple *vis-à-vis* the industry average.

The final offer price would be that price at which maximum number of shares are offered and not the price at which maximum number of share holders place bids. The delisting of Cadbury India Ltd. saw a protracted legal battle with several valuers being appointed by the company, the minority and the Court. The minority was insisting that the offer price of ` 500 was very low when compared with the DCF valuation of the company.

4 Epilogue

The essence of a valuation has been best summed up in the English Case of Re Dawdy and Hartcup (1885) 15 QBD 426 as follows:

> "......if a man is, on account of his skill in such matters, appointed to make a valuation, in such manner that in making it he may, in accordance with the appointment, decide solely by the use of his eyes, his knowledge and his skill, he is not acting judicially: he is using the skill of a valuer, not of a judge."

Thus, valuation is a complex phenomenon demanding much more than number crunching over a few excel spreadsheets. This complexity is heightened when it comes to regulatory valuations where certain parameters are laid down and it may be difficult to weave these requirements to the peculiar facts of a case. That is where a valuer's expertise and experience would come in handy. So examine the facts in the light of the regulations and remember Grabel's Law in each valuation:

> "Two is not equal to Three, even for very large values of Two!"

Dreams of the future better than the history of the past.

— *Thomas Jefferson*

Sharad D. Abhyankar, Solicitor and Mehul J. Shah, Advocate

Legal Issues and Case Laws on Valuation

The analysis is most important – how you took the data, analysed it, and wed it to your conclusion. I want to see your thinking – because that's what appellant court wants to see from me.

- Judge David LARO
– A senior Judge of the US Tax court

'The world is getting richer, healthier, better educated, more peaceful, and better connected and people are living longer, yet half the world is potentially unstable. Food prices are rising, water tables are falling, corruption and organised crime are increasing, environmental viability for our life support is diminishing, debt and economic insecurity is increasing, climate change continues, and the gap between the rich and poor continues to widen dangerously'[1]. "The earth is in such peril that it is clear that the world's largest economic agents – the corporations – cannot carry on as they have done in the past, pursuing profit maximisation without due consideration for the environmental and social cost they visit on society[2]".

Since past few decades, the economic, social, business and political environment all across the globe has undergone a significant change. The new economic order is challenging the conventional wisdom and theories of that created the wealth of nations and development of societies.

Over the past 10 years, venture capital finance has been a prominent source for start-ups and growth capital. It is observed that 'the firms supported by venture capital firms grow on an average, twice as fast as those without such funding. Venture capital funds usually invest in industries with great deal of uncertainty and information opacity, where information gaps between entrepreneurs and venture capitalists are commonplace and efficiency is illusive'[3].

The past five years have also witnessed the most severe consequences of market failures, irresponsible and short term behaviour. The business world over have also seen growing pressures for corporate governance for

1. From the Executive Summary of The Millennium Project-2011 – State of the Future Report.
2. Mr. Ratan Tata, commenting on 'Corporation 2020' by Pavan Sukhdev.
3. Venture Capital Contracting and the Valuation of High Technology Firms – Editors – Joseph A. Mc Cahery, Tilberg University and Luc Renneboog, Tilberg University & European Corporate Governance Institute, Brussls.

enhancing value of the stakeholders in the enterprise.

With enormous growth in economic activity, the need for evaluation of opportunities and risks has gone up substantially. The global markets have also seen development of new and innovative financial products. "Normal corollary to economic growth is the stakeholder's curiosity and interest in valuations of their respective investee institutions or potential investments or divestments"[4].

By 2025, India will have a potential to contribute 25% of the world's workforce. This realisation of demographic dividend calls for major reforms in education system and health sector. 'While skilled, trained and healthy young population with the right type of education is an asset, an uneducated or ill-educated, unskilled, less healthy, and unemployed population could lead to a demographic disaster.[5] While 89% of the jobs require vocational skills, only 11% of the working population undergoes vocational training of some kind. '58% of our graduates suffer from some degree of unemployability and formal on-the-job exposure is absent.'[6] The assessment of human capital and the capacity of organisations to attract and retain the best talent is fast becoming the necessary parameter for business valuation.

Estimation of Value : Types of Mandates

All of the above factors coupled with demanding international laws and accounting standards have resulted in greater demand for valuation services.

There are broadly two types of mandates for estimation of value –

(i) a valuation mandate; and

(ii) a calculation mandate.

Valuation Mandate

In a typical valuation mandate a valuer is required to express a clear opinion on value of an enterprise, ownership interest, etc. The valuer has freedom to apply a suitable valuation method that he considers appropriate.

Calculation Mandate

In a calculation mandate, the parties pre-agree on a valuation approach and method and the valuer is expected to calculate the value.

In cases where the regulations prescribe a valuation method (e.g., FDI Policy, SEBI Takeover Regulations etc.), the valuer's professional skill is limited to proper application of the approach and ensure that all the relevant information is gathered for the foundation of an opinion.

In India, certain statutes and the rules framed thereunder, prescribe a method of valuation to be followed by the valuers for valuation of an asset. 'In such cases, notwithstanding the fact that there may be several methods of valuing an asset, and even assuming that there was another method which was more appropriate, still the method chosen by rules, which was also one of the recognized methods, must be adopted'[7]. The methods like discounted cash flow method under the Foreign Direct Investment Policy in India, ready reckoner rates for sale of immovable property under Section 50C of the IT Act,

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4. From the background – Business Valuation Practice Standard – ICAI.
5. Chapter 12 : Human Development, Equity and Environment. – Economic Survey 2010-11, Government of India.
6. India's education emergency – India Labour Report 2012 – Team Lease Services & Indian Institute of Job Training.
7. *Bharat Hari Singhania vs. Commissioner of Wealth Tax (Central)* [1994] Supp 3 SC C 46

computation of value of shares to be issued on preferential allotment basis to QIP or any other person by a listed company, computation of the offer price under the SEBI (Substantial Acquisition and Takeover) Regulations 2011, etc., are examples where specific methods are prescribed by law or delegated legislation which are required to be followed while arriving at a value under the respective rules.

However, in cases *inter alia*, of deciding the share exchange ratio in a scheme of amalgamation under sections 391-394 of the Companies Act 1956 or issuance of shares by an unlisted company on private placement basis or valuing intangible assets, there are no methods prescribed under the statutes. The methods to be followed for the valuation have been left to the expertise and wisdom of the valuers.

Jurisprudence on Valuation

In this article, we try to analyse the judgements in which the valuation exercise and results were questioned before judicial fora.

The Constitution of India has conferred absolute powers and discretion to the courts in India to pass any order for meeting the ends of justice in deciding an issue arising out of a question of law or a fact. However, no court has competence to issue a direction to any party which is contrary to law nor can the court direct an authority to act in contravention of a statutory provision. In other words, the courts are meant to enforce the rule of law.

The valuation process and methodologies adopted by the valuers globally, has been subjected to scrutiny of various courts and fora in their respective jurisdictions. In India, the Supreme Court various High Courts and other judicial fora have from time-to-time, considered and discussed the issues arising out of a valuation process undertaken by the qualified valuers.

The courts have been generally asked to consider the following legal issues/questions regarding valuation: (i) What is the correct valuation?; (ii) What are circumstances under which a valuation of an asset can be challenged? and (iii) Who shall determine whether the valuation of an asset is reasonable and acceptable?

Valuation – a question of fact or law?

Before we see how the courts have responded to the above questions, it is pertinent to discuss whether valuation is an issue of fact or issue of law. The Supreme Court in *Duncans Industries Ltd. vs. State of UP*[8] held that the question of valuation is basically a question of fact and the Supreme Court is normally reluctant to interfere with the finding on such a question of fact if it is based on relevant material on record. It was further held that if the method adopted by the relevant authority for the purposes of the valuation is based on relevant material then it will not interfere with such a finding of fact. A similar view has been taken by Supreme Court in the matter of *Balco's Employees Union vs. Union of India*[9], *Anil Kumar Srivastava vs. State of U.P.*,[10] *G. L. Sultania and Another vs. SEBI & Another*[11]; *Ram Kishun vs. State of U.P.*[12]

Though valuation is a question of fact, it may have its roots in the question of law. The

8. (2000) 1 SCC 633
9 (2002) 2 SCC 333
10 (2004) 8 SCC 671
11 (2007) 5 SCC 133
12 (2012) 11 SCC 511

Supreme Court in the matter of ***Ram Kishun (Supra)*** held that though the valuation is a question of fact, it should be fixed on the basis of the relevant material on record. The Court further observed that the authority relying upon the valuation has to also apply its mind while approving/accepting the report of the approved valuer, while fixing the reserve price [for an auction].

In *G. L. Sultania and Another vs. SEBI & Another (supra)*, the Supreme Court followed the principles laid down in the case of *Dr. Renuka Datla vs. B. V. Solvay Pharmaceuticals*[13] and held that valuation of shares is not only a question of fact, but also raised technical and complex issues which may be appropriately left to the wisdom of the experts, having regard to the many imponderables which enter the process of valuation of shares. If the valuer adopts the method of valuation prescribed, or in the absence of any prescribed method, adopts any recognised method of valuation, his valuation cannot be assailed unless it is shown that the valuation was made on a fundamentally erroneous basis, or that a patent mistake had been committed, or the valuer adopted a demonstrably wrong approach or a fundamental error going to the root of the matter. Where a method of valuation is prescribed, the valuation must be made by adopting scrupulously the method prescribed, taking into account all relevant factors which may be enumerated as relevant for arriving at the valuation.

The Supreme Court in the matter of *CGT vs. Executors and Trustees of the Estate of Late Shri Ambalal Sarabhai*[14] held that the correct principle of valuation applicable to a given case is a question of law. The parties can agree upon a principle permissible under and recognised by law. If two or more alternative principles are equally valid and available, it might be permissible for the parties to agree upon the alternative modes of valuation in preference to another.

It is well settled by the courts that the question whether the correct principles of valuation applicable to a given case are followed or not would be a question of law, while the actual valuation of shares or an asset would be a question of fact. Valuation of shares being estimation only, is subjective in nature. It raises technical and complex issues and therefore should appropriately be left to the wisdom of experts. The court will not interfere with the valuation of an expert unless it is shown that some well accepted principles of valuation have been departed from without any reason, or the approach adopted is patently erroneous, or the relevant factors have not been considered by the valuer, or the valuation has been made on a fundamentally erroneous basis, or there is a fundamental error going to the root of the matter.

Is the derived value a correct value?

Valuation is not an exact science and is driven, *inter alia*, by the purpose of valuation, statutory requirements, business factors, etc. Valuation, in practice, is guided by a number of approaches as suitably adjusted for subjective circumstances. It is the duty of the valuer to not only arrive at the value but also recommend the fair way in which the asset is required to be valued and in such a way that each party is treated in a fair manner.

Generally, under a bilateral arrangement, a third party is involved for an impartial professional valuation of an asset in question. The process of valuation being subjective, the parties debate

13. (2004) 1 SCC 149

14 (1988) Supp SCC 115

and get different views prevailing regarding applicability of specific methods, as well as on validity and correctness of the formulae used for estimation. That being the case, it is very difficult to arrive at a conclusion that the value so derived is "correct", however, it can be summarised that it is an estimate of a fair value. When such valuation is challenged, the questions for consideration before the courts are whether (i) the valuation arrived at was a fair value and not made on a fundamentally erroneous basis; or (ii) that a patent mistake had not been committed; or (iii) the valuer adopted a demonstrably wrong approach; or (iv) a fundamental error occurred while going to the root of the matter and therefore whether the value derived is a correct and fair value?

Over the years, the Indian Supreme Court has admitted very few matters involving challenge to valuation of shares and that too only when an important question of law has arisen. Supreme Court recognised the needs of the dynamic business environment, liberalised economic policies, evolving labour legislation and international investors' perspective and follows the golden rule beneficial for protecting and preserving all stakeholders' rights and interest. This has added a new dimension to the jurisprudence governing mergers and acquisitions.

We summarise below some of the landmark cases decided by the Supreme Court and a few High Courts:

(i) In *Commissioner of Wealth Tax vs. Mahadeo Jalan & Ors*[15] the Supreme Court was required to decide the question on valuation under the Wealth-tax Act, i.e. what was the appropriate method for valuation of shares of a private limited company for the purpose of wealth tax. The Tribunal adopted the break-up method and arrived at the valuation of the shares on that basis, but on reference, the High Court took the view that in case of a company which is a going concern, the only proper method of valuation of shares is the yield value method and not the break-up method. The Revenue carried the matter in appeal to the Supreme Court. The Supreme Court, after examining the question of valuation of shares in-depth and after referring to various decisions of the English, Irish and Australian Courts laid down the following principles for valuation of shares in a limited company:

"(1) *Where the shares in a public limited company are quoted on the stock exchange and there are dealings in them, the price prevailing on the valuation date is the value of the shares.*

(2) *Where the shares are of a public limited company which are not quoted on a stock exchange or of a private limited company the value is determined by reference to the dividends if any reflecting the profit-earning capacity on a reasonable commercial basis. But where they do not then the amount of yield on that basis will determine the value of the shares. In other words, the profits which the company has been making and should be making will ordinarily determine the value, the dividend and earning method or yield method are not mutually exclusive; both should help in ascertaining the*

15. (1973)3 SCC 157

profit earning capacity as indicated above. If the results of the two methods differ, an intermediate figure may have to be computed by adjustment of unreasonable expenses and adopting a reasonable proportion of profits.

(3) In the case of a private limited company also where the expenses are incurred out of all proportion to the commercial venture, they will be added back to the profits of the company in computing the yield. In such companies the restriction on share transfers will also be taken into consideration as earlier indicated in arriving at a valuation.

(4) Where the dividend yield and earning method break down by reason of the company's inability to earn profits and declare dividends, if the set back is temporary, then, it is perhaps possible to take the estimate of the value of the shares before set back and discount it by a percentage corresponding to the proportionate fall in the price of quoted shares of companies which have suffered similar reverses.

(5) Where the company is ripe for winding up then the break-up value method determines what would be realised by that process.

(6) As in Attorney General of Ceylon vs. Mackie[16] a valuation by reference to the assets would be justified whereas in that case the fluctuations of profits and uncertainty of the conditions at the date of the valuation prevented any reasonable estimation of prospective profits and dividends."

(ii) The Supreme Court further observed that "In setting out the above principles, we have not tried to lay down any hard and fast rule because ultimately the facts and circumstances of each case, the nature of the business, the prospects of profitability and such other considerations will have to be taken into account as will be applicable to the facts of each case. But one thing is clear, the market value unless in exceptional circumstances to which we have referred, cannot be determined on the hypotheses that because in a private limited company one holder can bring it into liquidation, it should be valued as on liquidation by the break-up method. The yield method is, the generally applicable method while the break-up method is the one resorted to in exceptional circumstances or where the company is ripe for liquidation but nonetheless is one of the methods."

(iii) These principles of valuation were further discussed by the Supreme Court in the matter of Kusumben D. Mahadevia[17] in respect of the question of law under the Gift Tax Act. While agreeing to the view taken in the Mahadev Jalan's Case (Supra), the Supreme Court rejected the plea of the Revenue for adopting the mean of the values arrived at by applying the break up method and the profit earning method. The Supreme Court observed that there is no authority either in any judicial decision or in any standard text book on valuation of shares which recognises the validity of a combination of the two methods, though it may sound acceptable as a compromise formula. The Supreme Court dismissed the

16. [1952] 2 All ER 775
17. (1980) 2 SCC 238

appeal of the Revenue on the ground that the question of law proposed to be raised before the Supreme Court was neither dealt with by the Tribunal nor was it raised by the Revenue before the Supreme Court.

(iv) In Re: *Apex Investments Private Limited*[18]; Delhi High Court referred to the decision in the case of *Mahadev Jalan (Supra)* and explained the crux of the matter in more realistic terms. The Court observed that *"An arrangement for reconstruction or amalgamation of a company is essentially in the nature of a contract. What should be the terms and conditions of the contract has to be left for consideration by the concerned parties from a business point of view in a commercial sense. The adequacy of consideration for making the agreement is also for them to decide. The courts will not make bargains for the parties. Except in a case of fraud or prejudice to public interest, if the proposed terms of the arrangement are acceptable to the concerned parties, for considering grant of sanction of the scheme under section 391 of the Act the court will not interfere with it."*

(v) In *Hindustan Lever Employee's Union vs. Hindustan Lever Limited and others*[19] the Supreme Court observed that the jurisdiction of the Court in sanctioning a scheme of merger is not to ascertain with mathematical accuracy if the determination satisfied the arithmetic test. A company court does not exercise an appellate jurisdiction. It exercises a jurisdiction founded on fairness. It is not required to interfere only because the figure arrived at by the valuer was not as better as it would have been if another method would have been adopted. What is imperative is that such determination should not have been contrary to law and that it was not unfair to the shareholders of the company which was being merged. The court's obligation is to be satisfied that valuation was in accordance with law and it was carried out by an independent body. Since 95% of the shareholders who are the best judges of their interest and are better conversant with market trend agreed to the valuation determined, the court declined to interfere with the same.

(vi) It was further held by the Supreme Court in *Fertilizer Corpn. Kamgar Union (Regd.) vs. Union of India*[20] that "valuation could not be interfered by courts as certainly it is not part of the judicial process to examine entrepreneurial activities to ferret out flaws". The court is least equipped for such oversights. Nor, indeed, is it a function of judges in our constitutional scheme. We do not think that the internal management, business activity or institutional operation of public bodies can be subjected to inspection by the court. To do so, is incompetent and improper and, therefore, out of bounds. Nevertheless, the broad parameters of fairness in administration, *bona fides* in action, and the fundamental rules of reasonable management of public business, if breached, will become justiciable.

Issues concerning exchange ratio in amalgamations

(a) In the matter of *Hindustan Lever Employee's Union (Supra)*, the Supreme Court dealt with the issue of what method should be adopted for arriving at a proper exchange ratio, and also discussed the problem of valuation in the case of amalgamation of two companies:

18. 47 (1992) DLT 456
19. (1995) Supp (1) SCC 499
20. (1981) 1 SCC 568, 588-89

"This problem of valuation in the case of amalgamation of two Companies has been dealt with by Weinberg and Blank in the book "Take-overs and Mergers", in which it has been stated that some of all of the following factors will have to be taken into account in determining the final share exchange ratio :

(1) The Stock Exchange prices of the shares of the two companies before the commencement of negotiations or the announcement of the bid.

(2) The dividends presently paid on the shares of the two companies. It is often difficult to induce a shareholder, particularly an institution, to agree to a merger or a share-for-share bid if it involves a reduction in his dividend income.

(3) The relative growth prospects of the two companies.

(4) The cover (ratio of after-tax earnings to dividends paid during the year) for the present dividends of the two companies. The fact that the dividend of one company is better covered than that of the other is a factor which will have to be compensated for at least to some extent.

(5) In the case of equity shares, the relative gearing of the shares of the two companies. The 'gearing' of an ordinary share is the ratio of borrowings to the equity capital.

(6) The values of the net assets of the two companies. Where the transaction is a thorough-going merger, this may be mere of a talking-point-than a matter of substance, since what is relevant is the relative values of the two undertakings as going concerns.

(7) The voting strength in the merged enterprise of the shareholders of the two companies.

(8) The past history of the prices of the shares of the two companies.

It will, therefore, appear that in case of amalgamation a combination of all or some of the methods of valuation may be adopted for the purpose of fixation of the exchange ratio of the shares of the two companies. It is to be noted that even in such a situation, the book value method has been described as "more of a talking-point than a matter of substance."

(b) It was held that since the valuer had adopted the combination of three well-known methods of valuation of shares to arrive at the exchange ratio of the two companies and the financial institutions holding 41% of the shares of the transferor company and did not find any fault in the method of valuation of the shares, the Court should not interfere with such valuation.

(c) Similarly, the Supreme Court in *Miheer H. Mafatlal vs. Mafatlal Industries Ltd.*[21] held that once the exchange ratio of the shares of the transferee-company to be allotted to the holders of shares in the transferor-company has been worked out by a recognised firm of chartered accountants who are experts in the field of valuation, and if no mistake can be pointed out in the said valuation, it is not for the court to substitute its exchange ratio, especially when the same has been accepted without demur by the overwhelming majority of the share holders of the two companies or to say that the share holders in their collective wisdom should not have accepted the said exchange ratio on the ground that it will be detrimental to their interest.

21. (1997) 1 SCC 579

The High Court in sanctioning any scheme of merger or amalgamation has no jurisdiction to act as a court of appeal and sit in judgment over the informed view of the concerned parties to the compromise, as the same would be in the realm of corporate and commercial wisdom of the concerned parties. The High Court has neither the expertise nor the jurisdiction to delve deep into the commercial wisdom exercised by the creditors and members of the company who have ratified the scheme of merger by the requisite majority. Consequently, the company court's jurisdiction to that extent is peripheral and supervisory and not appellate.

(d) The Supreme Court in *Mihir Mafatlal's* case, while dealing with an issue that the share exchange ratio was unfair and unreasonable, observed as follows:

"….. It must at once be stated that valuation of shares is a technical and complex problem which can he appropriately left to the consideration of experts in the field of accountancy. Pennington in his 'Principles for Company Law' mentions four factors which had to be kept in mind in the valuation on shares:

(1) Capital Cover,

(2) Yield,

(3) Earning Capacity, and

(4) Marketability

For arriving at the fair value of share, three well known methods are applied :

(1) The manageable profit basis method (the Earning Per Share Method)

(2) The net worth method or the break value method, and

(3) The market value method."

The Supreme Court concluded that the exchange ratio was not unfair or unreasonable.

It quoted and affirmed sections of the decisions in Hindustan Lever Employees' Union & CWT vs. Mahadeo Jalan (Supra):

"Before parting with the discussion on this point it would be apposite to refer to the decision of this Court in Hindustan Lever Employees' Union (supra). In paragraph 41 of the Report Justice Sen speaking for himself and Venkatachaliah, CJ, and to which Sahai, J concurred has observed that the problem of valuation in the case of amalgamation of two companies has been dealt with by Weinberg and Blank in the book 'Take-overs and Mergers' in which it is stated that some or all of the 8 listed factors will have to be taken into account in determining the final share exchange ratio. The Court has also approved the fixation of exchange ratio of the shares of the companies on the basis of adoption of combination of two or more well-known methods of valuation of shares out of many such methods. In para 37 of the Report it has been observed that the question is what method should be adopted for arriving at a proper exchange ratio. The usual rule is that shares of the going concern must be taken at quoted market value. This principle was also recognised by this Court in the case of CWT vs. Mahadeo Jalan: [1972]86 ITR 621(SC). It is not the case of the appellant that M/s. C.C. Chokshi & Co. had not taken into consideration the quoted market value of shares of both the companies which were going concerns and which were subjected to the Scheme of Amalgamation in question. For all these reasons, therefore, there is no substance in this contention canvassed on behalf of the appellant that the exchange ratio was ex facie unfair to the equity share holders of the transferee-company".

(e) In the matter of Re: Brooke Bond Lipton India Ltd.[22], the Calcutta High Court has held that in a scheme of amalgamation, if the ratio of exchange has been fixed by an experienced and reputed firm of chartered

22. [1999] 98 Comp Cas 496 (Cal)

accountants, then in absence of any charge of fraud against them, court will accept such valuation and ratio of exchange. A mere allegation of fraud is not enough, it must be a proper charge of fraud with full particulars. In the instant case, there is no charge made or established.

(f) The Division Bench of the Bombay High Court in ***Dinesh Vrajlal Lakhani vs. Parke Davis (India) Ltd.***[23] ruled that the Court will not for instance interfere only because the valuation adopted by the valuer may have been improved upon had another method been adopted. The Court is neither a valuer nor an appellate forum to re-appreciate the merits of the valuation. What the court has to ensure is that the determination should not be contrary to law or unfair to the share holders of the company which has been merged.

(g) The Supreme Court in the matter of ***Dr. Renuka Datla vs. Solvay Pharmaceuticals B V*** (supra) has held that the valuer approached the question of valuation having due regard to the terms of settlement and considered from all appropriate angles. No case has been made out that any irrelevant material has been taken into account or relevant material has been eschewed from consideration by the valuer. The plea that the valuation is vitiated by fundamental errors cannot but be rejected.

By default, the Courts honour the wisdom and professional judgment of valuers

In the matter of ***G. L. Sultania*** (supra) the Supreme Court observed that not any one of the parameters is in itself decisive. All the factors have to be considered and the valuation arrived at. The regulation itself does not prescribe the weightage to be assigned to different enumerated parameters. As noticed earlier, many imponderables enter the exercise of share valuation. It must, therefore, follow that the weightage to be given to the different factors that go into the process of valuation must be left to the wisdom, experience and knowledge of the experts in the field of share valuation. Such being the method of share valuation which involves subjective and objective considerations, there is considerable scope for difference of opinion even amongst experts. Even if the correct principles are applied, different valuers may arrive at different valuations. Each one of them may be right, yet the valuations may differ. Mathematical precision and exactitude are not the attributes of share valuation, for at best the valuation arrived at by an expert is only his opinion as to what the value of the share should be. No doubt the variation may not be very wide between two valuations prepared honestly by two valuers applying the correct approach and the correct principles, but some variation is unavoidable.

Judicial Review by International Courts

Even the courts abroad are loath to interfere with expert valuations provided for by an agreement of the parties. It is well settled law that when parties contract and agree to a mode of valuation, that agreement will not be disturbed unless there is a showing of bad faith or some fraud, bias or other impropriety that implicates the fundamental fairness of the appraisal. Demonstrating error or a difference in professional judgment is not enough to create a question of fact. Nor is an appraiser limited to a particular appraisal method, unless the agreement provides otherwise.

In ***Singer & Friedlander Ltd. vs. John D. Wood & Co.***[24]***, Watkin J. of a UK*** court held that:

23. [2005] 124 Comp Cas 728 (Bom)
24. (1977) 2 EGLR 84

"…the valuation of land by trained, competent and careful professional men is a task, which rarely, if ever admits of precise conclusion. Often beyond certain wellfounded facts so many imponderables confront the valuers that he is obliged to proceed on the basis of assumptions. Therefore, he cannot be faulted for achieving a result, which does not admit some degree of error. Thus, two able and experienced men, each confronted with the same task, might come to different conclusions without any one being justified in saying that either of them has lacked competence and reasonable care, still less integrity, in doing his work……..Valuation is an art, not a science. Pinpoint accuracy in the result is not therefore to be expected by he who requested the valuation".

Who can challenge the valuation?

(i) In *Navjivan Mills Co. Ltd.* and *Kohinoor Mills Co. Ltd.*[25], the Gujarat High Court held that it would accept the judgment of the share holders evidenced by the votes cast by the share holders, both preference and ordinary, and unsecured creditors of Navjivan and would hold, keeping in view the huge majority the scheme has received, that the scheme is a reasonable and fair one and it is not oppressive of minority by majority.

(ii) Similar view has been taken by Andhra Pradesh High Court in *re: Sumitra Pharmaceuticals and Chemicals Limited*[26] and rejected the objection of the Central Government on the share exchange ratio which was approved by the shareholders and the creditors of the company.

(iii) The Allahabad High Court, in *re: Ratan Housing Development Limited*[27] while rejecting the objections of the Regional Director and the Official Liquidator, held that in the absence of fraud or malafides, mere fact that the determination of exchange ratio of the shares of the two amalgamating companies could be done by a different method giving a different exchange ratio, could not justify interference of company court unless it was found to be unfair. Where the share holders of the transferor- and transferee companies have unanimously approved the scheme of amalgamation and approved the exchange ratio, there is no reason to interfere with their decision and the High Court has to proceed on the basis of the ratio of exchange as approved by the share holders of the transferor-company as the fair ratio of the exchange.

(iv) The Division Bench of the Bombay High Court in *Anup Kumar Sheth vs Reliance Industries Limited and Others*[28] held that in absence of any material contradicting the conclusions reached with respect of valuation of shares and its fairness, it would be difficult to come to a finding that the conclusions reached with respect of valuation of shares and its fairness, it would be difficult to come to a finding that the conclusions drawn by expert were absurd.

(v) The Bombay High Court in *re: German Remedies Ltd.*[29] held that it is not for the court to sit in appeal over the valued judgment of the equity share holders who are supposed to be commercial men. Commercial men who know their common benefit and interests underlying the proposed scheme, with open eyes, have okayed the swap ratio by an overwhelming majority of 90 per cent in numbers and 99 per cent in value of

25. [1972] 42 Comp Cas 265 (Guj)
26. [1997] 88 Comp Cas 619 (AP)
27. [2004] 122 Comp Cas 24 (All)
28. [2010] 154 Comp Cas 278 (Bom.)
29. [2005] 125 Comp Cas 615 (Bom.)

the members present and voting. The limited jurisdiction of the court is only to see whether the ratio is so wrong or the error is so gross as would make the scheme unfair or unjust or oppressive to the minority of the members or any class of them.

(vi) The Company Law Board, New Delhi in *Ratika Overseas (P.) Ltd. vs Salter India (P.) Ltd. and Others*[30] while deciding an issue on Oppression/Mismanagement, held that as long as the valuer is unbiased and has followed accepted principles of valuation on proper material and justiable assumptions, the same cannot be questioned.

However, it has been seen from the past that the valuation is being and can be challenged by the following:

(a) **Minority share holders:** The minority share holders could challenge the valuation on the ground that either the scheme of amalgamation is unfair or that the share exchange ratio is unfair. Needless to say, the burden of proof would lie heavily on such minority share holders.

(b) **Creditors:** The creditors could challenge the valuation on the ground that the scheme of amalgamation is unfair to the creditors. Here again, the creditors will have to demonstrate objectively how their rights, security or claims could be prejudicially affected if the scheme were to be implemented.

(c) **Central Government:** Under section 394 A of the Companies Act, 1956 the Company Court issues a notice of the petition for scheme of amalgamation/merger to the Central Government for taking into consideration its representations before passing any order. The Regional Director, Ministry of Corporate Affairs, Government of India is the authority, which makes its representations if the scheme in question is against public interest or contrary to law. It is seen that the Regional Director has raised objections regarding the method of valuation adopted for determining the share exchange ratio. The Ministry of Corporate Affairs, Government of India has issued Guidelines by General Circular No. 53 of 2011 dated 26th July, 2011 addressed to Regional Directors and Registrar of Companies in relation to sending comments to the High Courts on behalf of Central Government. The Ministry of Corporate Affairs, Government of India requires the Regional Director to comment by way of a written statement of objections, report or an affidavit on the following important points among other:

(i) Valuation: (a) whether the valuation report is submitted; (b) if yes, whether the share exchange ratio is as per the valuation report and as per the GAAP;

(ii) Compliance: (a) whether any foreign entity is involved and if so necessary permission from Regulatory Authorities is obtained from regulatory authorities; (b) whether compliance of FEMA/RBI Guidelines has been done wherever applicable;

(iii) Circumvention or evasion of law: Whether the companies have come up with schemes to circumvent the law.

(d) In *Re Piramal Spinning and Weaving Mills Ltd.*[31] the Bombay High Court rejected the objection of the Regional Director as regards the fairness of valuation where there are no dissident share holders or

30. [2007] 139 Comp Cas 760 (Delhi)

31. [1980] 50 Comp Cases 514 (Bom.)

where the share holders have unanimously approved the scheme of amalgamation.

(e) The Division Bench of the Calcutta High Court in *Bengal Tea Industries vs. Union of India*[32] had also ruled that in the absence of any challenge from the share holders of the transferor company who are primarily and exclusively interested, the question of ratio of exchange of shares, the court is not inclined to interfere in the matter at the instance of the Regional Director.

Income-tax Department: It is also seen that the Income Tax Department has intervened and objected to the scheme of amalgamation/merger. In the matter *Hindustan Lever Employees' Union* (supra) the Supreme Court has by way of *obiter dicta* observed that the Court will decline to sanction a scheme of merger if any tax fraud or any other illegality is involved. In the case of *Jindal Iron and Steel Ltd.* the Single Judge of Bombay High Court relying upon the decision of the Division Bench of Bombay High Court in the case of *SEBI vs. Sterlite Industries*[34] has taken a similar view and declined to permit the Income Tax Department to intervene. However, the Single Judge concurred with the view taken by the Delhi High Court in the matter of *Mohan Exports India Limited vs. Tarun Overseas Pvt. Ltd.*[35] and the Gujarat High Court in the matter of *WoodPolymer Ltd. vs Bengal Hotels Pvt. Ltd.*[36] that if the only objective of the scheme is to avoid tax, such a scheme cannot be sanctioned by the company court. It is pertinent to note that in some of these cases, the entire scheme was challenged as a device of illegality and the valuation was not the only matter of challenge.

(f) **Regulatory Authorities:** *The Supreme Court in the case of G L Sultania's* (Supra) has observed that SEBI in its role as the regulator, is not required to pass reasoned orders as the same is not mandated under the SEBI regulations. Therefore, SEBI could either accept the valuation or reject the valuation upheld that matter. However, when it comes to right to appear/object before the Court in a scheme matter, the Division Bench of Bombay High Court has ruled in the case of *SEBI vs Sterlite Industries* (Supra) that SEBI has no right to be heard in the petition for sanction of the scheme and no right to appeal against the order of the company court sanctioning the scheme.

Conclusion

The Indian courts do recognise that valuation is a process and involves multitude of factors from historical perspective, financial matters, laws and regulations impacting the business, etc. The courts have also acknowledged that valuation is a technical and challenging discipline. The judiciary is conscious of the fact that the word value means different things to different people and the result will not be the same, should the context change, and that valuation is not an exact science. Valuation involves high degree of professional judgment, knowledge of business, analysis of facts, interpretation, developing financial models, methods and procedures, which may result into different conclusions in each given situation.

With this judicial recognition, comes a huge responsibility on valuers that the valuation

32. 93 CWN 542 (Cal.)
33. 1998 (93) Comp Cases 890
34. 53 CLA 41 (Bom.)
35. 95 Com Cases 53
36. 47 Com Cases 597

exercise and reporting must be relevant, meaningful and reliable. The objective of every valuer should therefore be 'to build confidence and trust in valuation process by creating a framework for delivery of credible valuation opinions by suitably trained valuation professionals acting in an ethical manner'[37].

The Institute of Chartered Accountants has made it mandatory for all valuers in India to abide by the Business Valuation Practise Standard that was brought into effect on 1st April, 2010. Further, the valuer should maintain an impartial attitude. A valuer should never develop or report biased analyses, opinions and conclusions.

A client is entitled to presume that the professional who signs the report is responsible for the findings and that the work has been either carried out by that professional or under his/her direct supervision. In case of joint valuers, the clients are entitled to assume joint and several liability of all the valuers.

In order to withstand the judicial scrutiny of business valuation, the valuers must also follow certain fundamental ethical principles:

Integrity	-	The valuer should be honest, fair, straightforward and truthful in professional relationships with clients;
Objectivity	-	The valuer must be fair and should not allow prejudice, conflict or interest or bias to override the professional judgment;
Competence	-	Valuer's professionalism would require exercise of sound judgment in applying knowledge and skill as well as clear understanding the purpose of the exercise; As a professional, it is not enough to attain professional competence but would require continuing awareness and understanding of relevant technical, professional and business development;
Confidentiality	-	A valuer must respect confidentiality of information acquired and should not disclose such information to third parties without appropriate authority;
Professional Due Care	-	Valuer must exercise due care to get sufficient information, conduct appropriate research and obtain relevant documentation and analyse the facts using high degree of professional skill and judgment.

Lastly, the valuer must clearly understand that the valuation exercise is very similar to delivery of justice. It is not enough that a job is done professionally. The Valuation Report is the true reflection of the valuer's performance. The report therefore should be clear and unambiguous. A valuation report must be a speaking report. If the valuer has exercised professional judgment in selecting a particular methodology of valuation, the report must set out in detail the rationale for such choice.

37. Introduction to the Code of Ethical Principles – International Valuation Standards Council, United Kingdom

CA Ravishu Shah

Valuation of Intangible Assets including Purchase Price Allocation

Investment in knowledge based/intangible assets is one of the key characteristics of modern economies. Every goods including physical assets have knowledge based content. This content increases as products become more sophisticated resulting in higher value addition and providing a source of competitive advantage for companies/businesses producing them.

Intangible assets are those assets that do not have a physical form/financial embodiment. But represents claims to future monetary benefits. e.g. brand, technology, distribution network, etc. According to Valuation of Intellectual Property and Intangible Assets by Gordon V. Smith and Russell L. Parr, 1994, *"Intangible assets are all the elements of a business enterprise that exist in addition to working capital and tangible assets. They are the elements, after working capital and tangible assets, that make the business work and are often the primary contributors to the earning power of the enterprise. Their existence is dependent on the presence, or the expectation, of earnings".*

The valuations of companies and businesses are increasingly driven by intangible assets rather than physical assets. Price/ book value ratio of BSE Sensex is currently at 3, i.e. the reported net worth of these companies accounted for only 1/3rd of their market capitalisation. A significant proportion of the difference between the market capitalisation and reported net worth of these companies is likely attributable to the intangible assets which are not reflected in their financial statements.

Valuation of intangible assets may be required in various contexts including:

- financial reporting purposes in connection with purchase price allocation ('PPA') or additional/ voluntary disclosure by companies
- tax purposes in connection with claiming depreciation on intangible assets
- transfer pricing purposes in connection with transfer of intangible assets *inter se* related entities
- transaction negotiations involving transfer of intangible assets
- litigation relating to infringement of rights, etc.

This article attempts to provide a brief overview of PPA process with particular reference to valuation of intangible assets.

Purchase Price Allocation

For many companies, mergers and acquisitions ('M&A') are key strategic drivers for creating share holder value. Although in theory the accounting and reporting for an acquisition should not affect the decision to buy or sell a business, its understanding can often facilitate the evaluation of a deal, including decisions about how to communicate

the transaction to various stakeholders. Accounting and valuation challenges have arisen for M&A transactions because of the complexities involved and requirements of various financial reporting standards.

Purchase price allocation ('PPA') involves measuring and recognising separately from goodwill, the fair value of identifiable assets acquired and liabilities assumed as of the acquisition date. PPA may be required for financial and/or tax reporting purposes. One of the key advantages of PPA is the transparency in reporting an acquisition to the stakeholders. On the other side, accounting of assets and liabilities at their fair value can materially affect future reported earnings and earnings volatility of an enterprise *inter alia* due to their periodical amortisation and impairment assessment .

Identification of assets

The starting point in a PPA process is to understand what assets exist in the acquired business. These assets may include fixed assets, current assets and intangible assets, some of which may not have been recorded in the financial statements of the acquired enterprise/ business.

Identification process may involve

- discussions with the management of the acquirer and target entities to *inter alia* understand the acquired business, key value drivers and acquisition rationale;
- understanding the pre-deal analysis carried out by the acquirer including financial, tax and legal due diligence, valuation, presentation to the Board/ promoters, etc.;
- reading of the acquisition related agreements like Share purchase agreement, Business transfer agreement, Non-compete agreement, etc.

Measurement of value

In valuation and accounting literatures, several definitions of the term 'value' can be found. For PPA purposes, identifiable assets acquired and liabilities assumed are measured and recognised at their fair value.

As per International Financial Reporting Standards ('IFRS'), fair value is "The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction."

In this context, "knowledgeable" means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the asset or liability, its actual and potential uses, and market conditions at the balance sheet date. A willing buyer is motivated, but not compelled to buy. The assumed buyer would not pay a higher price than the market requires. An arm's length transaction is one between parties who do not have a particular or special relationship so that the transaction is presumed to be between unrelated parties, each acting independently.

Fair value concept is based on the premise of 'Market Participant' assumption and acquirer specific considerations (whether synergies or costs) are not to be factored.

Fair value is not:

- Investment value which would encompass benefits expected by a particular buyer of the asset that are different from those available to market participants in general
- Book value based on historical and capitalised cost of an asset less accumulated depreciation or amortisation and which may not be reflective of its fair value
- Liquidation value where a seller is compelled to sell

Valuation of Tangible Assets

Tangible assets in case of a PPA would primarily include fixed assets and current assets.

Valuation of fixed assets require in-depth knowledge of various technical aspects and is

usually performed with the assistance of chartered engineers. Land is valued based on the basis of its market price considering various parameters like location, usage and development related restrictions, ownership nature (freehold or lease hold), demand and supply scenario, etc. Building/ Civil structure and plant and machinery are usually valued on the basis of their depreciated replacement cost considering *inter alia* current replacement cost, total economic life, balance economic life, estimated residual value, technical, economic and functional obsolescence, etc.,

Valuation of current assets is usually on the basis of their book value after considering adjustments for due diligence findings such as quality of receivables and advances (e.g. doubtful receivables, bad debts, non-recoverable advances) and inventory (e.g. slow-moving/ non-moving inventory items), etc. Finished goods inventory is usually valued on the basis of its net realisable value (i.e., estimated selling prices of the inventory, less costs of disposal and a reasonable profit allowance for the selling effort). Work-in-process inventory is measured similarly to finished goods inventory except that, in addition, the estimated selling price is adjusted for the costs to complete the manufacturing, and a reasonable profit allowance for the remaining manufacturing effort.

Valuation of Intangible Assets

As per IFRS, Intangible assets are assets, excluding financial assets, that lack physical substance.

Certain characteristics of Intangible Assets:

- They are capable of generating additional resources/cash flows/profits over and above those which the business would otherwise make if it did not own the rights in question
- They are capable of legal enforcement and also of legal transfer of ownership
- They are often separable from the underlying business
- The asset can be regarded as a capital asset rather than a carry over of recent expenditure

While tangible assets can be protected by physical custody, intangible assets can be protected only through legal rights. A strong legal system and a well developed property laws facilitate protection of legal rights of an owner of intangible assets. An understanding of the legal rights associated with an intangible asset and the legal environment provide an important qualitative perspective to the valuation of such assets.

Criteria for recognition of intangible asset in the financial statements

As per IFRS, for an identifiable intangible asset is to be recognised at fair value separately from goodwill, the asset has to meet either of the following criteria:

- Contractual-Legal Criterion: The intangible asset arises from contractual or other legal rights (regardless of whether those rights are transferable or separable from the acquired business or from other rights and obligations)
- Separability Criterion: The intangible asset is capable of being separated or divided from the acquired business and sold, transferred, licensed, rented, or exchanged (either individually or in combination with a related contract, asset, or liability)

Certain intangible assets which usually meet the aforementioned recognition criteria include trademark, trade name, non-competition agreements, customer contracts, non-contractual customer relationships, patented and unpatented technology.

Certain intangible assets which usually do not meet either of the aforementioned criteria include unidentifiable "walk-in" customers, customer service capability, presence in geographic locations or markets and specially trained employees. Further, IFRS specifically do not permit an assembled workforce to be recognised as a separate intangible asset

Valuation techniques for Intangible Assets

Valuation techniques generally employed in measuring fair value of intangible assets can be

broadly categorised under Income approach, Market approach and Cost approach. However, given the unique nature of most intangible assets, the income approach is most commonly used to value intangible assets acquired in a business combination.

Income approach

Income approach is a valuation technique used to convert future amounts to a single present value. A fair value measurement is based on current market participant expectations about those future amounts. The income approach typically is applied using the discounted cash flow (DCF) method, which requires:

- estimating future cash flows for a certain discrete projection period;
- estimating the terminal value, if appropriate; and
- discounting those amounts to present value at a rate of return that considers the relative risk of the cash flows.

Variations of the income approach often used to value certain individual assets are summarised in the table below.

- Multi-period excess earnings ('MEEM')

  MEEM is usually adopted for the leading/ most significant intangible asset out of the group of intangible assets being valued.

  Intangible assets are generally used in combination with other tangible and intangible assets to generate income. The fundamental principle underlying the MEEM is to isolate the net earnings attributable to the asset being measured.

  Under this method, estimate of an intangible asset's fair value starts with an estimate of the expected net income of the enterprise or a particular asset group. The other assets in the group are often referred to as "contributory assets," which contribute to the realisation of the intangible asset's value. "Contributory asset charges" or "economic rents" are then deducted from the total net after-tax cash flows projected for the combined group to obtain the residual or "excess earnings" attributable to the intangible asset.

  The contributory asset charges represent the charges for the use of an asset or group of assets (e.g., working capital, fixed assets, trade names) based on their respective fair values and should be applied for all assets, excluding goodwill, that contribute to the realisation of cash flows for a particular intangible asset. The excess cash flows are then discounted to a net present value. Finally, the net present value of any tax benefits associated with amortising the intangible asset for tax purposes is added to arrive at the intangible asset's fair value.

- Relief from royalty ('RFR')

  RFR method is usually adopted for measuring fair value of those intangible assets which are often the subject of licensing, such as trade names, patents, and proprietary technologies. The fundamental concept underlying this method is that in lieu of ownership, the acquirer can obtain comparable rights to use the subject asset through a licence from a hypothetical third-party owner. The fair value of the asset is the present value of licence fees avoided by owning it (i.e., the royalty savings).

  To appropriately apply this method, it is critical to develop a hypothetical royalty rate that reflects comparable comprehensive rights of use for comparable intangible assets. The use of observed market data, such as observed royalty rates in actual arm's length negotiated licences, is preferable to more subjective unobservable inputs. Market royalty rates can be obtained from various third-party data vendors and publications.

  One of the key inputs in using the RFR method is selecting the appropriate royalty

rate. Because most brands, trade names, trademarks, or intellectual property, such as patented or unpatented technology, have unique characteristics, the royalty rate selection process requires significant judgment. In certain instances, the underlying technology or brand is often licensed or sub-licensed to other third parties. The actual royalty rate charged by the company for use of the technology or brand to other parties is generally the best starting point for an estimate of the appropriate royalty rate. However, in the absence of such transactions, market-based royalty rates for similar products, brands, trade names, or technologies are used. Market rates are adjusted so that they are comparable to the subject asset being measured, and to reflect the fact that market royalty rates typically reflect rights that are more limited than those of full ownership.

- With and without method

  Under this method, the value of the subject intangible asset is calculated by taking the difference between the business value estimated under two sets of cash flow projections:

  - The value of the business with all assets in-place at the valuation date
  - The value of the business with all assets in-place except the subject intangible asset at the valuation date

The fundamental concept underlying this method is that the value of the subject intangible asset is the difference between an established, on-going business and one where the subject intangible asset does not exist. Key inputs of this method are the assumptions of how much time and additional expenses are required to recreate the subject intangible asset, and the level of lost cash flows that should be assumed during this period.

This valuation method is most applicable for assets that provide incremental benefits, either through higher revenues or lower cost margins, for the business, but where there are other assets in the business that drive the revenue generation of the business. Non-compete agreements. Given that the with and without method is an income approach, tax amortisation benefit of the intangible asset should also be included in determining the value of the subject intangible asset.

Market approach

Market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities, including a business. The market approach assumes that fair value can be estimated by analysing the observed trading prices in any market of comparable assets or liabilities and making appropriate adjustments for any differences between the observed transactions and the subject of the valuation.

Intangible assets tend to be unique and typically do not trade in active markets. For those transactions that do occur, there tends to be insufficient information available. However, there are some types of intangible assets that may trade as separate portfolios (such as FMCG/pharmaceutical brands,) as well as some licences to which this approach may apply. When applying the market approach to intangible assets, relevance and weight should be given to financial and key non-financial performance indicators

Cost approach

Cost approach, while more commonly used to value machinery and equipment, can be adopted for estimating the fair value of certain intangible assets that are readily replicated or replaced, such as routine software and assembled workforce. For other category of intangible assets, cost approach may fail to consider the expected economic benefits from future cash flows of the subject asset and/or the probability of success which may not be captured in a 'stand alone' cost estimate of the subject asset.

Key parameters in valuation of intangible assets

Discounting rate

The discount rate should reflect the risks commensurate with the cash flows of the individual asset category. Weighted Average Cost of Capital ('WACC') of the enterprise is generally the starting point and premiums and discounts are applied to the WACC to reflect the relative risk associated with the particular tangible and intangible asset categories. This process of disaggregating the discount rate is typically referred to as "rate stratification".

Some intangible assets, such as order or production backlog, may be assigned a lower discount rate relative to other intangible assets, because the cash flows are more certain, given the nature of the asset. Other intangible assets, such as technology-related and customer relationship intangible assets are generally assigned higher discount rates, because the projected level of future earnings is deemed to have greater risk and uncertainty of being achieved. While discount rates for intangible assets could be higher or lower than the entity's WACC, they are typically higher than discount rates on tangible assets. Due to its inherent nature, goodwill is usually assigned the highest discount rate amongst all the asset category

Weighted Average Return Analysis ('WARA') / Reconciliation of return

Rate stratification for the various classes of assets is a challenging process because it is often difficult to observe appropriate rates in any active market. Nonetheless, companies should assess the overall reasonableness of the discount rate assigned to each asset by generally reconciling the discount rates assigned to the individual assets, on a fair-value-weighted basis, to the WACC of the acquiree or the IRR of the transaction. This reconciliation is often referred to as a weighted average return analysis ('WARA'). The WARA is a tool to assess the reasonableness of the selected discount rates.

Contributory asset charges

When measuring the fair value of an intangible asset using the MEEM, contributory asset charges should be included in the cash flow projections of the intangible assets. The practice of taking contributory asset charges on assets, such as net working capital, fixed assets, and other identifiable intangible assets, is widely accepted among valuation practitioners. These charges generally represent a return on and, in some cases, a return of these contributory assets based on the fair value of such contributory assets.

The return of component encompasses the cost to replace an asset, which differs from the return on component, which represents the expected return from an alternate investment with similar risk (i.e., opportunity cost of funds).

For self-generated assets, such as customer lists, the cost to replace them (i.e., the return of value) typically is included in normal operating costs and, therefore, already is factored into the Projected Financial Information ('PFI') as part of the operating cost structure. Because this component of return is already deducted from the entity's revenues, the returns charged for these assets would include only the required return on the investment (i.e., the profit element on those assets has not been considered) and not the return of the investment in those assets. Where returns of the asset are not included in the operating cost structure, a return on and a return of value would be charged.

Life

To measure the fair value of an intangible asset, its projected cash flows are isolated from the projected cash flows of the combined asset group over the remaining economic life of the intangible asset. Both the amount and the duration of the cash flows are considered from a market participant perspective.

Terminal values are typically not appropriate in the valuation of a finite-lived intangible asset under the income approach. However, for indefinite-lived intangible assets, such as some trade names, addition of a terminal value to a discrete projection period would typically be appropriate.

Tax amortisation benefit

The present value of the intangible asset's projected cash flows should reflect the tax benefit that may result from amortising the new tax basis in the intangible asset. The tax amortisation benefit be factored into an asset's fair value, regardless of the tax attributes of the transaction (e.g., taxable or non-taxable).

In a non-taxable business combination, the acquiring company usually carries over the acquiree's tax basis. In such an instance, although no "step up" of the intangible asset's tax basis actually occurs, the estimation of fair value of the intangible asset should still reflect hypothetical potential tax benefits as if it did. A deferred tax asset or deferred tax liability should generally be recognised for the effects of such differences.

Generally, the tax amortisation benefit is applied when using the income approach and is not applied to the market approach. It is usually presumed that the market-based data used in the market approach already includes the potential tax benefits resulting from obtaining a new tax basis.

Common pitfalls

Common pitfalls when Measuring the Fair Value of Intangible Assets:

- Selecting discount rates on intangible assets that are not within a reasonable range of the WACC and/or IRR
- Using the MEEM to measure the fair value of two or more intangible assets with a common revenue stream leading to double counting or omitting cash flows from the valuation of intangible assets unless careful adjustments are applied (i.e., dual excess earnings)
- Determining the fair value of an intangible asset using the income approach without including the tax amortisation benefit
- Inappropriately selecting the cost approach to measure the fair value of an intangible asset
- Aggregating multiple intangible assets that may have different attributes and economic characteristics into a single intangible asset
- Failing to properly assess the economic life of an asset

Recent judgement for goodwill depreciation

The issue of claiming tax deduction for depreciation on goodwill has been subject to various litigations/ controversies in the past. In Aug. 2012, the Supreme Court ('SC') delivered a landmark judgment in Smifs Securities Limited's case relating to depreciation on goodwill arising on amalgamation. Applying the principle of *ejusdem generis*, the SC held that the excess amount paid over and above the book value of the assets taken over on amalgamation, being goodwill arising on amalgamation, is eligible for depreciation.

While the SC judgment affirms eligibility of a tax payer to claim tax deduction for depreciation on goodwill, it is to be seen whether any amendment is made to the Income-tax Act/ proposed Direct Tax Code to reverse its implications.

Conclusion

Valuation is not a precise science and the conclusions arrived at in many cases will, of necessity, be subjective and dependent on the exercise of individual judgment. Valuation of intangible assets involves greater subjectivity and valuer judgment due to their unique nature, inter-play between other tangible and intangible assets, lack of comparable market data in many cases, etc. Accounting and tax considerations do play a role in client's expectation and need to be balanced with reasonableness of value outcome.

CA S. Karthikeyan

Valuations – Investment Banker's perspective – Including Valuation issues in Negotiations

Historical perspective

Post independence Indian economy took the expected socialist path with few industrial houses gaining foothold in the major industries in India. As a slow progress the number of industries grew so also the industrialists. However most of these expansion plans were funded by vibrant financial institutional systems where large amount of debt was provided to facilitate the initial growth. Alongside the country had seen the presence of several multinational companies whose progress was largely due to parental funding. India never experienced the equity cult till such time Mr. Dhirubhai Ambani raised a fairly significant portion of his funding requirement by the initial equity offering for his famous flagship Reliance Industries Limited. This set a tone for equity offering to flow even though the pace was slow. A point which definitely was a deterrent to capital formation was unrealistic restriction on the equity valuation by the then Government Body named Controller of Capital Issues (CCI). CCI used to adopt historical norms while allowing the companies to seek public money to protect the interest of small share holders who were exposed to this culture for the first time. While achieving their objectives of protecting small stake holders, CCI valuation methodology was never appreciated by large industrial houses and hence they were always shy to seek public participation in their company. This trend continued till early 90's when the first change was initiated by the Government whereby companies were allowed to price the equity freely and the overall issuance was governed by a new body under the name Securities and Exchange Board of India (SEBI). For the first time SEBI initiated strict procedure for capital raising supported by strong disclosures. Without doubt Dhirubhai Ambani's dream offering laid the foundation for a strong capital formation which has happened in the subsequent decades.

Once the markets were thrown open and the much awaited free pricing era started, experts / financial controllers needed the help of financial tools to ascertain the intrinsic value of the equity. Broadly following approaches were generally adopted:

- Asset based approach;
- Income approach; and
- Market approach.

Asset based approach

The asset based approach focuses on the balance sheet value of a business enterprise and the fair market value of non operating assets, net of liabilities. The market values of operating assets are ignored due to concept of going concern. This method considers that a company's value lies basically in its balance sheet. They determine

the value from static viewpoint without considering company's earning potential, human resources, business contracts, etc.

Income approach

The concept of income approach is that the value of a business is the present value of the future economic benefits the business is expected to provide. This method determines the company's value through its earnings potential, sales, growth opportunities or other indicators. Some of the prominent methods under this approach are

Price earning method: P/E multiple is one of the most commonly used valuation methods, where the numerator is the price of the stock and the denominator is EPS. In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E.

Discounted cash flow method: This is one of the most popular methods used for valuing companies. Under this method projected cash flows from the business operations are discounted at an appropriate discount rate and the sum of discounted value of such free cash flows is the value of the business. The free cash flows represent the cash available for distribution to both the owners and the creditors of the business. DCF analysis involves estimation of future cash flows, appropriate discount rate to be applied for the cash flows and adjustment towards borrowings, surplus assets, cash, etc. and arriving at terminal value

Enterprise value to EBIDTA multiple: EV/EBITDA is one of the commonly used valuation metrics to arrive at enterprise value. EBITDA is commonly used as a proxy for cash flow available to the firm.

Sales multiple method: Sales multiple is the ratio of the value of Enterprise Value to Sales. This method is generally used as a cross check for the values arrived under other methods. Sales multiples can vary depending on the industry. Therefore, it's important to compare the multiple with other companies in the same industry or with the industry in general.

Market approach

Market approach attempts to estimate the value of business through the analysis and comparison of similar publicly traded companies. It evaluates the value on the basis of prices quoted on the stock exchange. Average of quoted price is considered as indicative valuation of the company by investors operating under free market conditions.

Free pricing and the subsequent changes

In a climate which had no regulatory restrictions on the pricing, the Indian capital markets saw some of the leading industrial families offering its shares through the IPO viz. Godrej, Dabur, BPL, etc. These issues were priced based on intrinsic strength of its business rather than historical formulas. This clearly set the tone for large capital formation in India and the events subsequent to this have reaffirmed the status of equity as a important source of funding. Concurrently India saw the initial entry of private equity funds who played an important role in the capital formation. Though it is still in the initial phase as compared to western countries large PE funds who have strong presence in International markets have scripted their entry into the Indian corporate world. In the late 90's and early 2000 India saw Jardine Fleming, CDC, ICICI Venture, Draper International, Warburg Pincus made a quiet entry with serious investments aggregating to billions of dollars in new generation companies as well as established frontiers. Concurrent to this Indian corporates were greeted by International markets with capital formation through instruments like ADRs, GDRs, FCCBs, etc. Thus in the decade spanning between 90's and 2000 Indian corporate enjoyed the breadth of a large market across globe supported by innovative financial instruments.

Once the cult of equity offerings stabilised, need for a deep understanding in financial tools became the critical aspect of fund raising. While there is no denial of the acceptance and existence of traditional valuation methods, approach by investors moved far away from

the tools to a combination of theoretical and practical approaches. It is a common experience that investors who are largely institutionalised put in a combination of critical parameters which eventually provides what is known as the best judgment value. Among the parameters promoters profile, past experience and their governance standards account for well over 50% and the rest is accounted by a collection of financial tools described above. Thus while application of financial tools is essential, performance of the promoter, company and the industry also play an important factor to determine the valuation. Needless to state these factors can never be spelt in any text books which outlines valuation methodology.

One can safely say that what is not taught in class room has become the foundation of the current valuation methodology. To give few examples recent transaction of CavinKare, speaks volumes about the emphasis placed by the investors on the ability of promoters to steer the company as against a pure number play. If one carefully analyses the numbers this transaction could be dubbed as most expensive but given the vast experience of the promoter and the governance standard deployed by the group the valuation remains an attractive proposition. However it is a common belief that no transaction can be lopsided be it for investor or promoter. Every valuation is based on a belief that the equity issued by a company is based on the belief that the promoter and the management will deliver the results assuming the overall macro condition remains the same.

Another example of rich valuation is acquisition of Hotmail by Microsoft. If one were to review this purely on number it would be difficult to justify the valuation. However Microsoft considered this option purely from increasing the subscriber base within a short time frame.

Notwithstanding what is stated above and the common belief that the investors have sound judgment, there are instances where they have failed due to excessive hype about the company and hence the value. It is well accepted fact that there are countless instances where a company enjoys a premium valuation due to the hype around its business but have failed to live up.

A classic example and the most recent one is of Facebook.

In 2012, Facebook raised $5 bn with exorbitant valuation of $ 38 per share and a market capitalisation of $ 104 bn but within three months the stock fell to $ 19.69 per share. After one year since debut it's trading at $ 24.16 per share with a market capitalisation of $ 58.42 bn. The market capitalisation is reduced to half since the IPO, clearly indicating that the sociological trends and factors alone cannot determine the value.

On other hand we have Google who lived up to the hype. In 2004, Google raised $1.67 bn with valuation of $ 85 per share and a market capitalisation of $ 23 bn. Google share traded at $ 280 after a year from the IPO with a market capitalization of $ 76 bn, a threefold increase in a year, today Google is trading at $ 788 per share.

If one looks at closely events which have unfolded post Facebook collapse, Twitter which is in the same media and probably has the same value may be the first casualty of a conservative valuation rather than the high premium valuation. Here it is a foregone conclusion that twitters valuation may be more linked to failure to Facebook rather than financial parameters of the company. Such examples are far many but one can see few surprises emanating from the crowded basket.

In select situation while the methodology described above and the macro factors going against the valuation environment the company in question may still enjoy a premium thanks to various factors such as exit of competition, transfer of controlling stake, acquisition of new geography/market and/or a wider diversification which will add value for the acquirer in future.

The purpose of above discussion is to reconfirm our belief that valuation is a game of perception followed by application of financial parameters and judging its quality.

CA Niraj Sanghvi

Valuation Issues in International Transactions

Scope

International Transactions can be of many types: Mergers & Acquisitions, Joint Ventures, Cross-Border Projects, Intellectual Property Licensing, Franchising, etc. All these transactions have some or many elements of valuation & capital budgeting. This article restricts the discussion only to International Mergers & Acquisitions, popularly called Cross Border Mergers and Acquisitions ('CM&A') and its valuation.

Financial Literature states that the ultimate goal of a corporation is to create shareholder value. The figure below attempts to represent the building blocks of shareholder value, in simple terms.

The Goal: Increase the share price of the firm

$$\text{Price} = \text{EPS} \times \left[\frac{P}{E}\right]$$

Increasing the share price means increasing the earnings.

Management directly controls through its efforts the earnings per share of the firm/

Management only indirectly influences the market's opinion of the company's earnings as reflected in the P/E

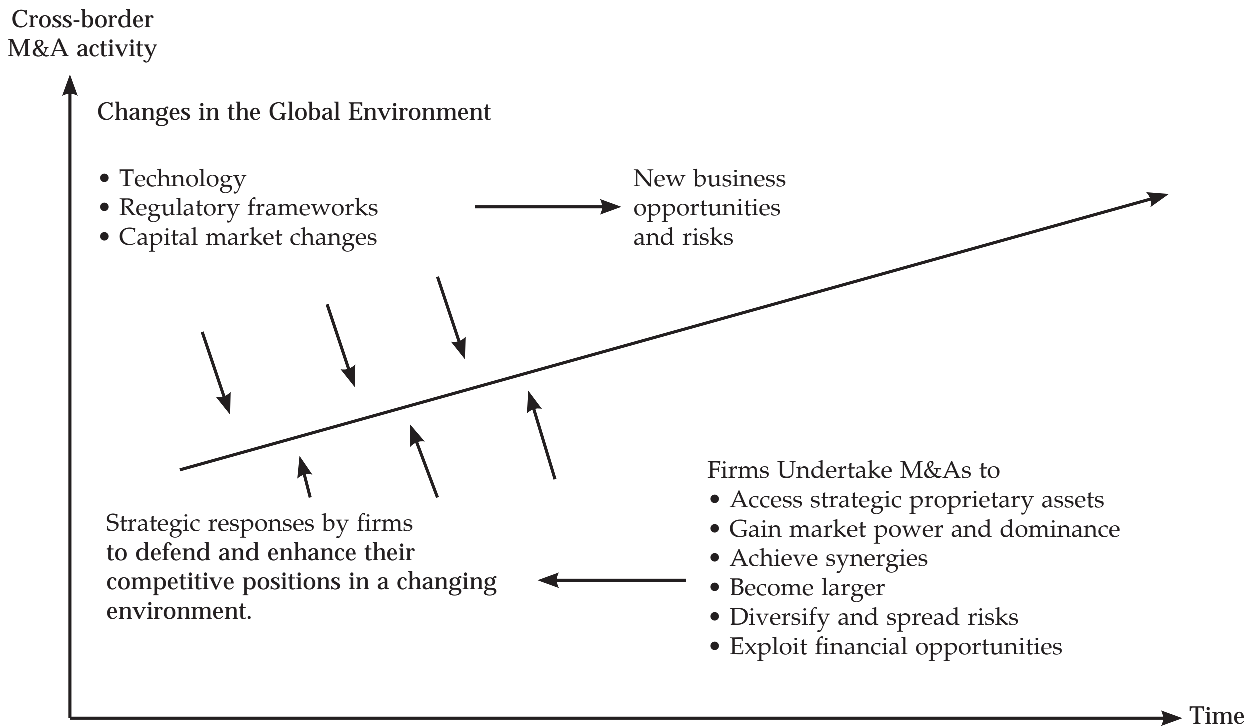
So building "value" means growing the firm to grow earnings.
The largest growth potential is global.

CM&A – Rationale

As explained above, there are many levers of building shareholder value, but the ultimate lever is growth. There comes a time when corporations exhaust growth opportunities in the local markets and start looking at distant shores for fuelling their ambitions in the search for the ultimate lever. An increasingly popular route to this quest is through CM&A. In addition to quench their thirst for growth, corporations are driven to undertake CM&A for a variety of reasons. The drivers of CM&A activity are both macro in scope—the global competitive environment— and micro in scope—the variety of industry and firm-level forces and actions driving individual firm value. The primary forces of change in the global competitive environment—technological change, regulatory change, and capital market change—create new business opportunities for corporations, which they pursue aggressively.

The United Nations Conference on Trade and Development (UNCTAD, formerly the U.N. Centre for Transnational Corporations) has summarised the mergers and acquisitions drivers and forces relatively well in the figure below:

Source: UNCTAD, World Development Report



2000: Cross-Border Mergers and Acquisitions and Development, figure V.1., p. 154.

CM&As are as much as prone to risks and pitfalls, if not more, as domestic M&As. As with all M&A transactions, domestic or cross-border, there are problems of paying too much or suffering excessive financing costs. Melding corporate cultures can be traumatic. Managing the post-acquisition process is frequently characterised by downsizing to gain economies of scale and scope in overhead functions. This results in non-productive impacts on the firm as individuals attempt to save their own jobs. During CM&As, additional difficulties arise from host governments intervening in pricing, financing, employment guarantees, market segmentation, and general nationalism and favouritism. The table below shows the various factors which affect implementation of a CM&A. You will note that although many factors overlap

with a domestic transaction, the complexity is more due to cultural mis-matches and a lag in the understanding of the logic or background relating to a particular factor.

Factors Affecting Implementation of International Transactions

	Legal Barriers	Tax Barriers	Supervisory Rules	Economic Barriers	Attitudinal Barriers
a) Execution Risks	1. Legal uncertainty 2. Opaque decision making processes 3. Legal structures 4. Limits or controls on foreign participations 5. Defense mechanisms 6. Impediments to effective control 7. Difficulties to assess the financial situation	14. Uncertainty on Tax arrangements 15. Uncertainty on VAT regime	23. Concerns regarding financial stability 24. Misuse of supervisory Powers 25. Supervisory Approval Process		35. Political Interference 36. Employee's reluctance 37. Shareholder acceptance of quotation changes 38. Shareholder and analyst apprehension of failure risk
b) On-Off Costs	8. Restriction on offers	16. Exit tax on capital gains			28. Market Fragmentation
c) On-Going Cost	9. Employment legislation 10. Accounting systems 11. Divergent consumer protection rules 12. Data protection 13. Differences in Private Law	17. Transfer Pricing 18. Inter-Group VAT 19. No Homogenous Loss Compensation 20. Specific Domestic Tax breaks 21. Discriminatory Tax Treatments 22. Taxation on Dividends	26. Divergences in supervisory Practices 27. Multiple reporting requirements	29. Different Product Mixes 30. Non-Overlapping Fixed Costs 31. Lack of middle-size institutions 32. Absence of critical size 33. Market Power 34. Differences in Economic Cycle	39. Political Concessions 40. Consumer Mistrust in foreign entities

While a valuer cannot assume the role of the management or expert, the valuer will be able to guide clients better, if the valuer draws the attention of the management to the relevant factors and ensures that the above factors have been 'priced' properly while deriving the fair value of the transaction.

The key success factors for an acquisition are: (a) the ability to integrate the target, (b) the quality of the pre-acquisition valuation and (c) the quality of the target's management.

In this article we shall focus on the common issues one encounters while valuing an international transaction.

Financial Statement Analyses

All of us would agree that this is the first step on proceeding with an effective valuation. The Target's financial statements provide pointers to how economic value is created by the Target and how the economic value created by the Target is distributed. Conceptually, the aim of the valuer is to determine the economic value that is left for the owners and determine a value that a buyer will pay today in return for the economic value he will earn in the future. This is true, irrespective of whether the transaction is domestic or a CM&A.

In case of a domestic transaction, the above analysis is simpler as the accounting rules, standards & conventions are the same. However, the problem in an international transaction is amplified as the Target may follow a different set out accounting rules vis-a-vis those applicable in the base jurisdiction of the acquirer. The acquirer and the valuer need to fully understand whether the accounting rules, depict the true economics of the Targets business.

While harmonisation of accounting rules (read application of IFRS), may be a solution, in certain geographies, there are differences between accounting treatment relating to various items between geographies, e.g. there are a specific set out IFRS which is applicable in the European Union, which may be different *vis-a-vis* the IFRS applicable in India. A valuer should however, be aware of these differences and endeavour to base his valuation on the true economic profitability of the enterprise. This is crucial as:

1. The historical economic distribution of the enterprise is the starting point to any valuation. This is the basis to understand the next point.
2. The future economic distribution of the enterprise – synergies need to be considered in the valuation. It is important to note that synergies can be both positive and negative. While positive synergies are obvious, in the heat of deal-making, negative synergies are not identified or ignored.
3. Sustainability of the current financial profile of the Target.
4. Additional potential liabilities or discovery of unaccounted for assets/ liabilities, needs to be considered in the overall valuation.

The endnote is that, a comprehensive financial analyses is a key ingredient during the valuation of CM&As.

Common Issues in Valuation (Multiple based approaches)

Because it is difficult to account for the various factors that affect the DCF valuation process in a cross-border context, many firms resort to using shortcut methods. While these shortcut methods are not

generally recommended by academics, many prominent multinationals use them. The attempt here is to set out some general guidelines in respect of certain commonly used multiples.

1. **Asset Multiples:** The asset multiple approach values a company as a multiple of an important industry asset. The following equation sets out how the asset multiple is used: (Observable Asset) x (Asset Multiple) = Valuation. Using an asset multiple to value a cross-border project is certainly the simplest valuation method, but it abstracts away from the specific risks associated with cross-border projects, and thus frequently obscures more than it explains. The key failure of the asset multiple method is that it does not capture the future use of the asset i.e. the same asset may be used by different corporations to serve different set of customers or may require different inputs. This may change the future economic distribution of the combined corporation. This is further complicated in the international context, as an asset when expected to be used to serve a global customer base, may have a different future economic distribution vis-a-vis, the one it currently generates. One has to be extremely careful while using asset multiples and the future economic distribution should be carefully analysed prior to using asset multiples.

2. **Revenue/Profit Multiples:** The usual practice is to use historical revenues/ profitability & multiply the same with a comparable listed firm in the same geography to arrive at the valuation. Many times listed corporations apply multiples applicable to their own stock to value Targets, on the assumption that on acquisition, the market will place the same value on the Target as the acquirer. These approaches can lead to gross mistakes. While using revenue and profit multiples one must keep in mind the sustainable economic profile of the target and carefully choose the relevant comparable listed firm(s) whose multiples need to be used. In the case such relevant comparable firms are not available, adjustments may be considered based on the evaluation of the differences between the operations of the firms and the target. One must also consider whether certain temporary fiscal benefits/regulatory measures affect the target which may not be relevant going forward, especially given the current global economic environment.

3. **Transaction Multiples:** Sometimes, firms are valued based on past transactions. While application of this approach leads to certain complexities in the domestic environment, problems are further exacerbated in the case of CM&A. One of the rules a valuer may apply is (where available) use cases where transactions have happened in the same geography as the target. Where such data is not available, the valuer may consider adjusting the multiple or the financial metric of the target to reflect the valuation, based on the relevant sustainable financial metrics of the target.

In my view, multiple based methods may be used as a supplement to the Discounted Cash Flow ('DCF') method. One should also ensure that the multiple based approaches should appropriately reflect the sustainable economic reality of the target and should

appropriately reflect the estimable risks underlying the markets in which the target operates currently & is expected to operate post the transaction.

Common Issues in Valuation (DCF approach)

In principle, there is little difference between domestic and cross-border valuation. From the perspective of a domestic parent, project value is still the present value of expected cash flows discounted at the appropriate risk-adjusted cost of capital.

However, when considering how to value a potential CM&A, several issues emerge that make the problem more complicated than the classical DCF exercise described in finance textbooks (one country, one currency, one set of country and industry risk factors). Some of the key issues

1. WHICH CASH FLOWS NEED TO BE VALUED

In overseas investment decisions, there is often the question about whether to consider the entire cash flow or only the portion repatriated. My answer is immediate: consider the investment's entire cash flow, not just the portion to be repatriated. The reason is that even the portion reinvested overseas affects the intrinsic wealth of the investor, because the reinvestment increases the value that the investment can be sold for, and thus needs to be included in the analysis. So one should consider an overseas investment's entire cash flow, not just the portion repatriated.

2. WHICH CURRENCY SHOULD BE USED

The first step is to select the currency you will use to create financial projections for the CM&A. The general rule of thumb is to use the currency in which most revenues and costs occur. Simple rules while selecting a currency: (a) If a Company mostly has domestic revenues & domestic costs, use the domestic currency. (b) If a Company mostly has international revenues & international costs, use the currency where most of the revenues and costs occur. Convert other revenues & costs to the aforementioned currency. The issue becomes more complicated in case revenues & costs are incurred in different currency. In such cases the custom is to use the currency in which most of the revenues occur. This brings us to an additional question: Which currency rate should be used to convert? Generally projections should be drawn using fixed exchange rates & sensitivity of foreign exchange rates should be tested on the ultimate cash flow.

3. HOW SHOULD A DISCOUNT RATE BE CHOSEN

The discount rate is used to adjust future cash flows to the present time. It should reflect both the time value of money and project risk. The more uncertain are a CM&A's returns, the higher rate at which future returns should be discounted. Risk is determined by a variety of factors – including country risk, anticipated shifts in exchange rates, and the volatility of the local business environment. The first step, however, is to determine whether to use the home country discount rate or the local country discount rate as the starting point. When using the home country discount rate, you should make appropriate adjustments for country, devaluation, and business risk. If the local discount rate is used, no adjustments are needed.

4. HOW SHOULD ONE-SIDED RISKS BE ADDRESSED

Risks that face either an upside or downside variance, but not both, are referred to as

asymmetrical (or one-sided) risks. One-sided risks are common to a CM&A. An example of an upside variance would be the potential for a follow-on investment after a project starts. A downside variance would be the possibility of expropriation. One-sided risks are accounted for in the DCF by performing scenario analysis. The model is constructed by calculating a NPV for each possible scenario and assigning probability ratios to each. The weighted average of all the scenarios (both positive and negative NPVs) contributes to the total project NPV.

Using the probability weighted scenario model is the more appropriate approach to account for one-sided risks, particularly in cases where the probability of the risks change over time. It would be inaccurate to adjust the discount rate for one-sided risks.

5. SENSITIVTY ANALYSES

Once the valuation is calculated, a sensitivity analysis should be performed to determine how changes in key assumptions affect the valuation. It is important to remember that a valuation is a best guess estimate of the target and does not say anything about the variance around this best guess. The assumptions made when constructing the pro forma projections should be analysed to measure their effect on the valuation. This will help the analyst understand the leverage points in the valuation model. While sensitivity analyses is a common feature even in domestic transactions, this assumes a special role in a CM&A, as the variables are much higher in the quest to find the sustainable economic profile of the target. Special note should be given to currency exchange rates, country risk premiums, tax regime, government regulations and relative business risk, while performing the valuation. The variances, while performing the sensitivity analyses will give the valuer valuable clues on the most sensitive drivers, which will allow him to make an informed judgment on the true value of the target.

Summary

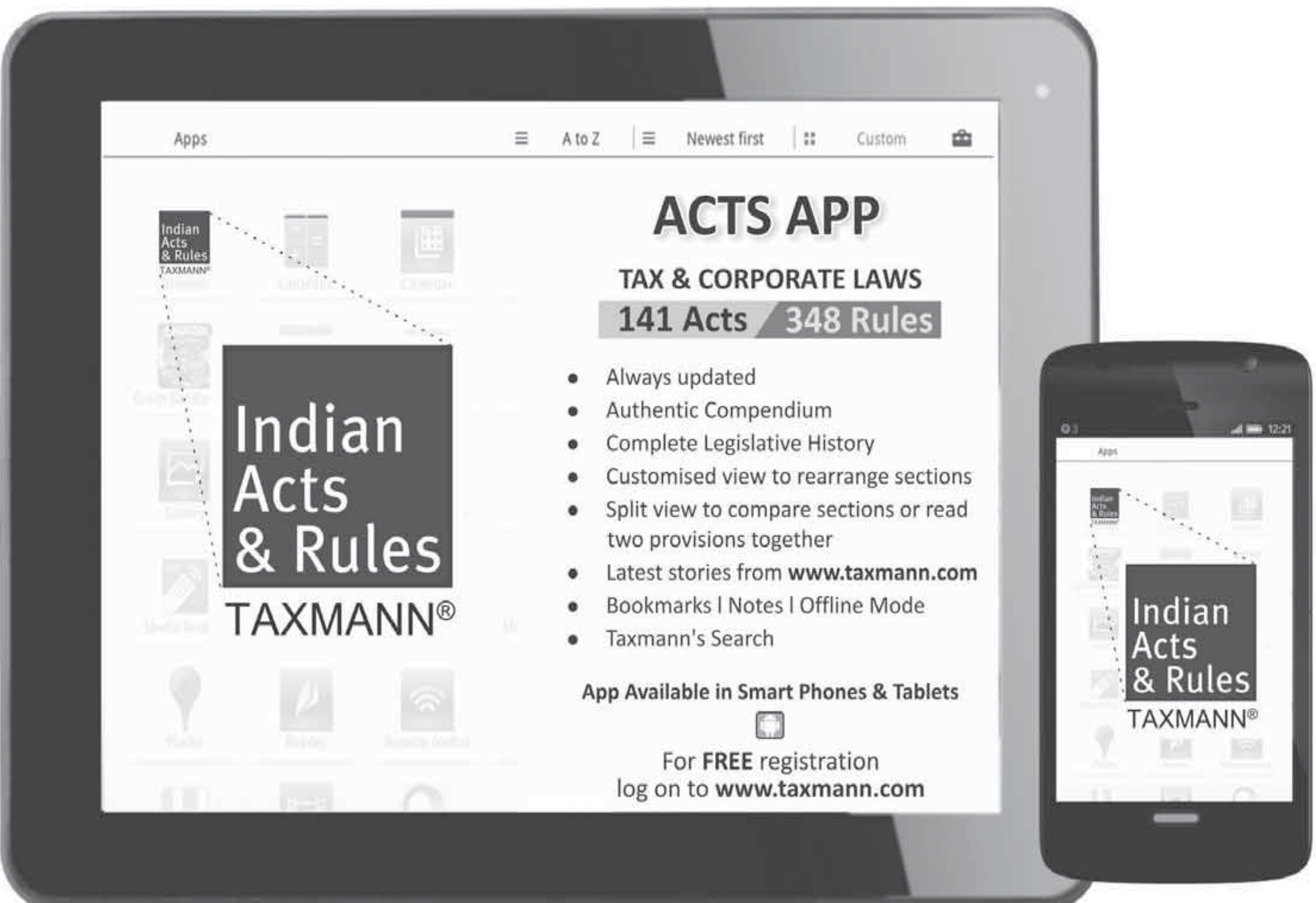
There are no significant conceptual differences between valuing a domestic transaction and a Cross-border M&A transaction. One should remember that in both cases, the valuation should reflect the value of such enterprise based on a sustainable economic profile of the target. Herein lies the challenges and the true difference between valuing a Cross-border transaction and a domestic transaction. The risks are different, the operating profiles are different, customer sets being addressed are different, currencies are different and most importantly, the profile of current and future distribution of the economic benefits accruing to the enterprises are different.

I have attempted to highlight some of the key issues that one may encounter while valuing a Cross-border M&A transaction and provide a practical, framework.

> It is but a truism that labour is most productive where its wages are largest. Poorly paid labour is inefficient labour, the world over.
>
> — *Henry George*

Case Laws Index

ACIT vs. Balarampur Chini Mills Ltd. 109 ITD 146 45
Anil Kumar Srivastava vs. State of U.P. (2004) 8 SCC 671 62
Attorney General of Ceylon vs. Mackie [1952] 2 All ER 775 65
Balco's Employees Union vs. Union of India (2002) 2 SCC 333 62
Bengal Tea Industries vs. Union of India 93 CWN 542 (Cal.) 72
Bharat Earth Movers vs. CIT 245 ITR 428, ... 44, 45
Bharat Hari Singhania vs. Commissioner of Wealth Tax (Central) [1994] Supp 3 SC C 46 61
Bharat Hari Singhania vs. CWT 207 ITR 1 46
Brooke Bond Lipton India Ltd. [1999] 98 Comp Cas 496 (Cal) 68
CGT vs. Executors and Trustees of the Estate of Late Shri Ambalal Sarabhai (1988) Supp SCC 115 63
CIT vs. Tulsyan NEC Ltd 330 ITR 226 45
Commissioner of Wealth Tax vs. Mahadeo Jalan & Ors (1973)3 SCC 157 64
CWT vs. G.M. Abhayankar HUF 214 ITR 269 46
CWT vs. Mahadeo Jalan: [1972]86 ITR 621(SC) 68
CWT vs. S Ram 147 ITR 278, ... 44
Dinesh Vrajlal Lakhani vs. Parke Davis (India) Ltd. [2005] 124 Comp Cas 728 (Bom) 69
Dr. Renuka Datla vs. B. V. Solvay Pharmaceuticals (2004) 1 SCC 149 63
Dr. Renuka Datla vs. Solvay Pharmaceuticals B V (supra) 69
Duncans Industries Ltd. vs. State of UP (2000) 1 SCC 633 62
Fertilizer Corpn. Kamgar Union (Regd.) vs. Union of India (1981) 1 SCC 568, 588-89 66
G. L. Sultania and Another vs. SEBI & Another (2007) 5 SCC 133 62
Gold Coast Selection Trust Ltd. vs. Humphrey, 17 ITR Suppl 19 (HL), ... 47
Hindustan Lever Employees' Union & CWT vs. Mahadeo Jalan 68
Hindustan Lever Employee's Union vs. Hindustan Lever Limited and others (1995) Supp (1) SCC 499 66
Kusumben D. Mahadevia (1980) 2 SCC 238 65
Metal Box Company of India vs. Their Workmen 73 ITR 53 44
Miheer H. Mafatlal vs. Mafatlal Industries Ltd. (1997) 1 SCC 579 67
Mohan Exports India Limited vs. Tarun Overseas Pvt. Ltd. 95 Com Cases 53 72
Ram Kishun vs. State of U.P. (2012) 11 SCC 511 62
SEBI vs. Sterlite Industries 53 CLA 41 (Bom.) 72
Singer & Friedlander Ltd. vs. John D. Wood & Co. (1977) 2 EGLR 84 69
WoodPolymer Ltd. vs Bengal Hotels Pvt. Ltd. 47 Com Cases 597 72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ABOUT THIS YEAR'S ESSAY COMPETITION AND ACKNOWLEDGEMENTS

THE DASTUR ESSAY COMPETITION

The Direct Tax Committee of Chamber of Tax Consultants takes the privilege to share with all, the success of The Dastur Essay Competition, 2013 organised by the Direct Tax Committee for the students pursuing Law and Accountancy. Students from esteemed Universities all over the country participated in the competition.

Topics chosen for Essay were as under:

1. Morality and Profession.
2. Role of a Professional in Corporate Social Responsibility.
3. Media – A voice of.....

The competition was divided in two rounds; first and final rounds. In the first round we selected the best 11 essays for the final round which were again judged by a pair of judges to decide the winners.

We sincerely thank the professionals for judging the first round of competition

- Mr. Apurva Shah
- Mr. J. I. Patel
- Mr. K Gopal
- Mr. S. N. Inamdar
- Mr. Vipul Joshi
- Mr. V. H Patil

We would like to express our deepest gratitude to the Members of Income Tax Appellate Tribunal Mumbai namely Hon'ble Shri D. Manmohan Vice President, Mumbai and Hon'ble Shri R S. Syal Accountant Member for evaluating the essays for the Final round of the competition.

The best essays awarded are as follows:

Sr. No.	*Position*	*Name*	*College Name / Institutes Name*	*Subject*
1	1st	Ms. Shreya Yogesh Jatia	Singrodia Goyal & Co., Chartered Accountants, Mumbai	Morality and Profession
2	2nd	Mr. Dhavnish Jagdip Shukla	S. V. Doshi & Co., Chartered Accountants, Mumbai	Morality and Profession
3	3rd	Mr. Saurabh Rajendra Wagle	CVK & Associates, Chartered Accountants, Mumbai	Media – A voice of ……..

4	4th	Mr. Yashvardhan S. Gupta	N. A. Shah Associates, Chartered Accountants, Mumbai	Morality and Profession
5	5th	Mr. Syed Tamjeed Ahmad	Jamia Millia Islamia (Central University), New Delhi.	Media – A voice of ……..
6	6th	Ms. Isha Ketan Shah,	Government Law College, Mumbai.	Role of a Professional in Corporate Social Responsibility
7	7th	Mr. Prateek Kamal Sachdev	Majithia & Associates, Chartered Accountants, Mumbai	Role of a Professional in Corporate Social Responsibility
8	7th	Mr. Kush Kalra	Kurukshtra University, Haryana	Media – A voice of ……..
9	8th	Mr. Bharat Shiva Gowda	Anil Thakrar & Co. Chartered Acountants, Mumbai	Media – A voice of ……..
10	9th	Ms. Dewanshi Pankaj Vora	Ghalla & Bhansali Chartered Accountants, Mumbai	Morality and Profession
11	10th	Ms. Rajvi Jayesh Doshi	Pune Indian Law Society (ILS), Pune	Role of a Professional in Corporate Social Responsibility

Special Thanks

- Hon'ble Shri D. Manmohan Vice President, ITAT Mumbai and Hon'ble Shri R S. Syal, Accountant Member, ITAT for judging the Final round of the competition
- Mr. S. E. Dastur, Senior Advocate for his esteemed suggestions, guidance and support
- President and the entire Managing Committee for confidence and faith shown
- Principal of law colleges and the professionals for encouraging students to participate in the competition

Sd/-
Ajay R. Singh
Chairman
Direct Taxes Committee

Mumbai
Dated: 29th June, 2013

Morality and Profession

Shreya Yogesh Jatia

Targets, work pressure and client-queries and complaint;
Things around which life revolves and other things faint.
No denial about the job satisfaction,
And a person may well get time for self rejuvenation.
This is the story of profession!
Expert ideas, advices, innovations strike minds,
But one thought for which time, one never finds.
Time for the thought of morality.
While empathising, while toiling for company's dignity
While undertaking team work, while resolving others blues,
Unknowingly, unconsciously each one follows moral values.
Through these subtle moral traits we see ourselves achieving goals,
Imagine the achievement when everyone would make a sincere effort,
An effort to imbibe morality deep in our blood.
Imagine the pleasure, the peace of mind and clean conscience,
That eternal satisfaction and fulfilment without any penance,
Which is unexplainable by any Science!

Indeed in this fast-paced life, morals and values to be thought about consciously seems a little out of the way thinking. Its superficial complexity deludes our mind to believe that the cloud won't burst or we won't face a setback if we do not give effortful attention to how morality impacts our profession.

But this indeed is a complete myth! Morality and profession are as integrated as is soul to body or water to life. The inseparable relation can be better deciphered by understanding what profession is and what morality is.

A person having special knowledge or skill acquired through education or experience is said to practice profession.

More specifically four general criteria indicate a profession and typify the persons who occupy the roles therein: specific training, autonomy, public service and ethical codes.[1]

Morality refers to having moral values. These moral values help to discriminate between what is good or what is bad, i.e. guide between ethical and unethical. Moral values include honesty, benevolence, humility, love and affection for others, thinking well about others and so on. The word "Morality" trickles down to these simple human traits, 'human traits' that distinguish us from other creatures who have organs, intelligence in their own way but lack these virtues.

1 Barry L. Padget, Professional Morality and Guilty Bystanding: Merton's Conjectures and the Value of Work, Cambridge Scholars Publishing, 2009, p. 2.

In words of Plato, a thinker and philosopher,

"Morality is not simply a question of our own individual preferences or desires, but is reflected in the community of which we are a part, just as the community is a reflection of the nature of the collective souls which constitute it"

Thus, morals are a shared understanding, within a group of people, of how to live and work together.

"Human morality is firmly anchored in the social emotions with empathy at its core."

– Frans de Waal

Like the air we breathe, the moral system is so much a part of our everyday experience that it is hard to see it clearly.[2]

A thought process may help bring it into focus. Imagine that there is a group of people, completely strangers, who have set out for an adventure trip in a Jungle. One of them sees a member stuck in a morass and immediately alerts the other members. A rescue team forms:

one arranges a strong vine or a tree branch, one of them stands guard, another wading out brings the victim back while others may just try to boost each ones morale. The person is rescued; everyone celebrates that evening around the campfire with a can of beer and some music.

How did the group co-operate so effectively in a new and urgent situation while none of them being familiar to each other? They all reacted emotionally, empathised with the victim's distress, and became eager to help, even though it put some of them at personal risk and distracted everyone from more personally advantageous activities. Cognition and memory were needed to plan the rescue. The expression of joy required communication.

But what brought it all together were morals – the group's shared understanding of how people should behave. In that group, it was understood that everyone should be willing to sacrifice their time and take risks to help out, that ideas should be pooled to make the most effective plan, that roles should be assigned according to capabilities, and that, afterward, everyone's contribution should be recognised and appreciated.

Now, in order to establish the relation between profession and morality, we need to understand the rationale and basis of emergence of profession and professional institutions.

One of the catalysts of morality is the thought about well-being of others. Needs of people arise and they look up to those with capabilities and power to suffice their needs. People who have competence and ability along with wherewithal to fulfil those needs, come forward to serve, out of natural duty to each other, just in virtue of being human. This natural duty is governed by moral values. Specialists like doctors, lawyers, teachers and all others have emerged for the need of safeguarding the health, rights of the people, spreading the knowledge for enlightenment and so on. Thus, when the needs emerge and keep on multiplying, these experts come together, form a 'profession' and 'institutions' to satiate the requirements of the masses and thus an obligation or a duty, which was already present earlier, now gets recognised as being a part of a profession.

Naturally, a bond between the professionals and masses is created based on some kind of trust and expectations. In order to ensure survival of this smooth relation, the expectations of the masses need to be met. To make certain that these expectations are met the 'professional institutions' carve out certain norms based on general moral values commonly known as 'code of ethics'. Thus, all this process involves making an inherent promise to serve and behave in a particular way while taking on a certain role which is represented and governed by morals.

2 Daniel Friedman, Morals and Markets, Palgrave Macmillan, 2008, p.19

Thus, it is inferred that profession and morality are integrated to each other although; it is true that the existence of such integration is not solely due to the process of development of profession as described above. Other bases for relation between profession and morality are also discussed later on.

Now that the link is established between moral values and profession, a question arises as to what is morality or immorality in profession. Moral acts in a profession would include actions backed by moral thoughts. It would involve caring for the stakeholders, carrying out ethical business practices and so on. Whereas immorality involves harassment of others at workplace, deceiving and other such acts.

The role morality of individual professionals encompasses their obligations, virtues and so on in respect of clients and colleagues, as well as their duties to the institutionalised collective that they jointly constitute. In short it is a professional's behaviour towards all the stake holders and elements of the society. Professional morality is not confined to one's own profession but involves perspectives about other professions as well. Considering a particular work superior and the other inferior is no way being ethical.

Where one can find that certain acts can be classified on the basis of morality are confined to particular professions such as illegal trade of human organs by doctors for organ transplants, treachery in accounts by an accountant, use of cheap materials in construction and pocketing the surplus money by civil constructors and so on……..; certain acts are violation of humanity as a whole which can be experienced in any profession such as mental or physical abuse, work place politics, life threats and so on.

Morality would also mean being clear and upright, having objectivity and not blindly seconding what the superiors or the bosses say. Also if a person is aware of an immoral act occurring and has turned a deaf ear to it, then keeping mum would mean partnering that unethical act.

Within "Letter to an Innocent Bystander" Merton explains the notion of by standing and rejects the argument that one can remain honourable while being a "helpless witness" to appalling conditions. Merton asserts that one cannot be a detached observer while maintaining one's innocence. It is a mistaken belief, according to Merton, that innocence relieves one of responsibility.[3]

When moral values sound so good then, why do people resort to depravity or dissipation at all?

Omar Bradley, Major General of the Army, USAFR has remarked –

"We have grasped the mystery of the atom and rejected the Sermon on the Mount. The world has achieved brilliance without wisdom, power without conscience. Ours is a world of nuclear giants and ethical infants."

This indeed seems to be true.

Christopher Lasch once put it:

"Money, even more than other good things like beauty, eloquence and charm, has a tendency to „seep across the boundaries and to buy things that should not be for sale: exemption from military service; love and friendship; political office."

When we look today, can those exemptions still be considered as excluded from the tyranny of money? Not definitely after Bofor's' scam, choppergate scandal or more prominently known as helicopter scam in India and Note for Vote' scam.

Day in and day out we hear of swindles. Remember Satyam, Enron, Commonwealth games, Lehman Brothers? Even media and journalism are not spared with their indulgence in hypocrisy and paid news. Today professions like modelling and acting demand compromises

3 Barry L. Padget, Professional Morality and Guilty Bystanding: Merton's Conjectures and the Value of Work, Cambridge Scholars Publishing, 2009, p. 5

of morals. We have heard about casting couches. The list continues. Certain issues have a passing effect while certain others leave a scar in our mind putting us into psychological dilemma as to how could these nuisances ever take place? So why do these things happen at all? What causes the people involved therein to become a part of such acts devoid of morals?

Most of the times, it is personal desires, craving for material success, arrogance, vengeance and other such thoughts, needs and greed that lead to immoral acts. In the conviction to always be ahead in the rat race of materialistic seizure, one‘s ability to discriminate, to discriminate between the right and the wrong fades and the mind is deluded.

Resorting to immorality is also because of fear, fear to be deprived of the position, status and comfort enjoyed presently. In the case of Enron one of the reasons for resorting to malpractice was the pressure to achieve the set performance target lest the seat is always empty for the "achiever" or "performer" who gives "results".

The most mind-jolting reasons of all is when the reason for an immoral act is mere pleasure and causing pain to others.

But sometimes deviating from moral values may be out of helplessness as observed in professions. "Fine, if you cannot in conscience meet the expectations and duties of the profession, leave it or choose a different line of work."

They say either strip off your moral values or leave the job – the choice is yours. Indeed! it is 'our choice'. Mere having moral beliefs is not sufficient but courage to stand to it is also important. Thus, as we recall of the example of Ashok Khemka, the IAS Officer who used to be harassed and given life threats, got around forty three transfers but yet did not give away his morality to the sufferings caused by the ruthless and continued to carry out his duty to expose the corrupt. This is what one needs to imbibe.

Plato, a philosopher, believes that we have an innate sense of "the Good," and that good is connected to the good of the community. But when we become overly concerned with our own prosperity or desires, our sense of the good becomes distorted, and the entire community suffers.

The profession‘s knowledge base has come at the expense of attention to social work's values and mission. We are today experiencing shifting emphases of the profession from service to a materialistic approach with a craving for acquisitive success.

“Desire for the possession of anything becomes an obsession when it grows out of proportion.”

— Swami Chinmayananda

This desire leads to arrogance and in this arrogance the conscience or subtler call within a person to discriminate between the right and wrong becomes dulled.

These are depicted by two verses in the sacred Bhagavad Gita

“Enveloped, O son of Kunti, is wisdom by this constant enemy of the wise in the form of desire, which is as difficult to cease as fire.”

— III : 39, Bhagavad Gita

“Bound by a hundred ties of hope and given to passion and anger, they strive to obtain by unlawful means hoards of wealth for sense enjoyments.”

— XVI : 12, Bhagavad Gita

Some may say that financial problems so grave as to questioning survival may induce a professional to immorality.

Professions, because they are both implicitly and explicitly committed to human well-being, struggle with the ideals and pursuit of excellence in conflict with organisational roles and institutional demands. As a result a forced gulf is created between one‘s ideologies and one‘s actions and this conflict inflicts actions that

may be professionally ethical but if considered as a social member is immoral. In the context of the professional-client relationship, the professional is obligated to act in a fiduciary manner; to always and without exception favour the well-being and interest of the client. This precludes activities that constitute a conflict of interest on the part of the practitioner.

Though the tasks of professional ethics are to identify moral standards and assessments, judgments and concepts, characterising people as representatives of a particular profession; following through with the implementation of values articulated in the code may sometimes result in divergence between personal moral beliefs and commitments of the profession's members.

One is wedged between morals and professional ethics. Should a lawyer take up a case to defend a culprit? Should a doctor support the idea of abortion as demanded by the patient? The debate for allowing Euthanasia is long prevailing in India. Thus, the lawyer is on crossroads whether to abide by the duties set by the ethics of law or follow his moral instinct and not take up the case thereby defeating the code of conduct of a lawyer. Similarly, the doctor is in dilemma whether to carry out the abortion which would mean to kill a life, merely to fulfil the obligation of serving the patient. Thus, there are many instances where a professional has to tussle between his conscience and the professional obligations.

"It is curious - curious that physical courage should be so common in the world, and moral courage so rare."

— Mark Twain

Path of the good is not as easy to walk through as one can stride through the path of effortless achievement. It is always observed that obstacles come but in that situation only one thought should come to the mind: 'The Choice is yours'. We may not get a third choice which is like a midway. Instead of shying away from the situation one has to decide in which direction to proceed. The path of truth and morals requires grit, strong conviction, perseverance and patience.

The words of Winston Churchill must enter every nerve and artery of humans –

"A man does what he must - in spite of personal consequences, in spite of obstacles and dangers and pressures - and that is the basis of all human morality."

An underlying question is why should anyone be bothered so much about morality in his or her profession especially when conflicts are bound to happen?

One feature that makes practicing profession stand out from mere performance or undertaking of business activity is its dedication and service to the community, to the common good.

Professionals are given a place of authority and dignity in society. They are in a position to influence large number of people. They represent their profession as a whole. So as to maintain the integrity of the profession, it is necessary that the professionals follow values of common morality.

Thus, as said 'with great powers come great responsibility', in order to ensure constructive utilisation of power, attachment of moral values with profession is necessary. The reason that nation places people in uniform or in special positions is to protect and promote the values of their society, or more simply stated, to protect their way of life.

'As the professional's power is authorised by society through legislation and regulation, and as professionals possesses specialised skills, training, and experience and has the capacity to make choices in an authoritarian manner, the moral imperative that all professionals uphold is to use this power for good.

Professional Values and Ethics make company's productivity to rise. Performance depends on

the way people communicate with each other, the attitude they have about their job and how well they meet their responsibilities. In other words, for an organisation, professional values and ethics guidelines shows how it expects the employee to behave while being employed and what moral standards should he meet so that optimum efficiency is achieved.

'Morality for success', Sounds absurd at the first instance?

"When one gets on the top he has to step on the head of others" – this thought is considered as generally acceptable. But is it universal? Can success and morality be sustained together? The answer to this questioned co-existence is 'yes'. David Schwartz in his book 'The Magic of Thinking Big' says that any organisation would not hire a person who is self-centered, whose thoughts revolve only around big fat salary cheques, fringe benefits, perks, luxurious and comfortable life but would always welcome a person who may not be as intelligent but is considerate, believes in success of group/ company as a whole and not individual/ departmental progress. In any company he who makes efforts without expectations, works towards mutual benefit of self and those around is always revered. No one can stop such a person from climbing up the ladder of success and for them material achievements come like a by-product.

So, what do the traits described of the successful person in the immediate paragraph describe? Aren't these signs of moral values? So, can success and morality co-exist? Yes! They can!

Moreover definition of success is also to be considered. Whether it is immediate but short lived or slow but long lasting? Should success only mean having a villa, owning a Lamborghini, dining in a 5-star restaurant and having all the luxuries of life? Often a question is asked, can morality fetch money? Can moral values feed empty stomach? Not in the short run but morality always pays off in the long run. Self-respect, peace of mind, eternal pleasure is what one gets out of being moral. And no money in the world can buy these!

To be successful, it is necessary to be moral, since negative and immoral thoughts can paralyse intelligence and the ultimate result is destruction of self. We definitely cannot change our intelligence but we can direct whatever knowledge we have, and an apt direction will lead to the path of success.

Many desire to become leaders in whatever profession they are. For that we need to imbibe certain qualities such as being considerate, striving for progress of the entire group, being impartial, having an open-mind, being a patient listener and practicing empathy and so on.... Aren't these moral traits as well? Can leadership be achieved being aloof to these values?

Consider Mr. Narayan Murthy. This boy from the average family who eyed on engineering right from the childhood, today, is a Padma Vibhushan, was listed as one among the 12 greatest entrepreneurs of our time by the Fortune magazine in 2012, awarded the 2012 Hoover Medal and the James C. Morgan Global Humanitarian Award 2012 by The Tech Museum, California, has about 25 honorary doctorates from universities in India and abroad, has served on the boards of Ford Foundation, Rhodes Trust and so on. Yet, he is still the humblest one. He took the effort to initiate Indian industry to ethics, business values and many key corporate governance initiatives, making it loud and clear that good values do not always translate into bad business. This is Narayan Murthy, founder of Infosys (which is now, listed on the Nasdaq Stock Exchange); and a classic example that success and morality can thrive together.

Henry Ward Beecher says what is depicted here

"Every young man would do well to remember that all successful business stands on the foundation of morality."

Another example is of Dr. APJ Abdul Kalam.

The eminent scientist and engineer, former President of India is one such person who constantly thinks how through his professional subject like Science and Technology can be used for development in India. As appears from Dr. Kalam's experiences as shared by him in his book 'Ignited Minds', even when holding the highest possible post, he was always on a move visiting various parts of India, interacting with the youth and always modest.

People like these are there to inspire the youth aspiring for their individual professional careers.

The following pearls of wisdom aptly fit here –

"It is true, no doubt, that those who live these great values of life will be a mere few in society, but those few will soon grow up to such a stature in themselves that they will be leading the world with an irresistible secret spiritual power of their own"

— Swami Chinmayananda

Morality is also necessary for social and professional acceptance. In order to maintain a good standing in a well functioning group is a powerful human motive, and this can be achieved through morals. Consider a group of professionals or employees in an organisation. Suppose one of the members is always back stabbing, full of hypocrisy, always establishing his superiority over others and boasting about his achievements. How long will the group or the organisation sustain him as an inmate or a member?

The above arguments in favour of morality included more of a profession as a benefit to the individual professional and those around. Now let us consider the bigger picture.

Who makes an economy run? What leads a nation towards development? To educate there are teachers. The business class thereafter acquires all management and enterprising skills that enhance productivity. They together form industries. To help them take appropriate investment and other financial decisions there are financial analysts and economists. For efficient productivity, apart from skilled, a healthy workforce is required. For that we have the medical practitioners. To ensure sound functioning of the governance and support we have bureaucrats and the law makers. To maintain overall peace we have the police and the military. For development of infrastructure, which acts as a basis for other economic activities, engineers, architects are of prime importance. And ultimately the one who decides upon the entire nation's policy is the Government composed of politicians.

Barring politics which may not be considered as a profession by many, the fact that an economy and so a nation can stand resolute is due to the combined sincere and indomitable work efforts of the profession classes at various levels.

These can be gauged through comparative analysis of two countries.

Russia was a well-flourishing nation but the recent past shows that how immorality uprooted the well being of people paving way for the rise of Mafiya. From instances as mentioned in the book 'Morals and Markets' evidently puts on view that over there, everyone right from the judges to the bankers to the officials had surrendered to corruption, either out of hunger of power and money or out of fear for survival. As a result a 'moral bankruptcy' was created. The journalists who tried to oppose were shot dead.

"You rob your workplace. You cut in line. You skip out on contracts if it's convenient. Dishonesty is deep-rooted. When a person in business is honest, it is because he has made a conscious, and usually temporary, decision to be honest. There is not a deep-rooted sense of ethics."

— Vladimir Aleksayan,
Russian Import-Export Executive

This thought truly depicts the environment prevailing in Russia and distrust among common people.

Like how the Russian might diminished, similarly a person too experiences a psychological fall –

"When a man thinks of objects, attachment for them arises.

From attachment desire is born, from desire arises anger.

From anger comes delusion, from delusion loss of memory.

From loss of memory comes the destruction of

discrimination, and from destruction of discrimination he perishes."

— III : 62-63, Bhagavad Gita

To work their magic, markets, which is composed of industries and professionals and general public, need the right kind of competition. When firms vie to offer customers better quality and lower prices, we get a value overflow that markets split among customers, suppliers and owners. The magic vanishes when competition, instead, is for currying government favours, stealing property, and murdering rivals. That sort of competition killed economic growth in ancient empires and in medieval times, and did so again in Russia under the oligarchs and Mafiyas.

Ultimately, it is morals that channel competition in productive directions.

Markets live on voluntary exchange, which requires trust. You have to believe that strangers won't be cheating you before you'll deal with them. You have to think the banks are honest before you'll put your money in them. You have to believe that you can freely walk down the road and there is always law and order to protect you. While seeking justice you have to keep faith in the judiciary. You have to believe what the other person is selling won't result at least in purposeful damage or harm. This sensitivity of market towards trust and customer service was well depicted in the Bollywood movie: Rocket Singh Salesman of the Year.

People trust the system, consider the professionals to be trustworthy and believe that the promises made will be kept intact. This holds together the people and profession and both grow mutually. Once this trust is shattered then, as experienced from the Russian case even powerful empires turn into ashes, economy disrupts affecting all.

But there was one country in another part of the world progressing continuously leaving the entire world astonished.

After the Second World War and the atomic bomb blasts who would have expected that a small sized country like Japan would build world class manufacturing facilities within two decades and belittle other giants? That it would give tough competition to a country like the U.S.A., considered as the super power?

What made this happen? And what differentiates Japan from Russia?

Consider the following excerpt –

"Firms in Japan enjoyed friendly ties with regulators, as management did with labour, while bosses made decisions by consensus with their underlings.

Politically, Japan became a vast back scratching system, with bureaucrats, business managers, and politicians all helping each other. It has been governed by a lone political party since long, namely, Liberal Democratic Party (LDP). For most of its time in power, the LDP has rotated the top position – Prime Minister – among factional leaders in the party. Real power lies with career bureaucrats in key executive departments such as the Ministry of Finance and Ministry of Trade and Industry. Thanks to generous campaign contributions from industry, politicians seldom face annoying challenges, bureaucrats subsidise farmers and encourage savings and low-cost financing for key industries, and top bureaucrats often retire to lucrative positions in industry, a practice called "decent from heaven".

Mutual support is the linchpin everywhere. Workers are expected to actively aid others

on their team, and the team is expected to take initiative in improving performance. The moral code also calls for management to consult extensively with workers, and for everyone to build consensus changing anything important. In-group morality softens market competition within and across firms in the kieretsu (groups of industries) to make them tougher competitors in foreign markets."[4]

So what do the Japanese have to teach us?

First, judicious use of power for benefit of all. Second, understanding limitations and giving opportunities to others as well. Third, respecting the competence of subordinates and co-workers by involving them in decision making process. Third, giving importance to team work. And above all, demonstrating to the world how integrity within various professional groups leads to economic wellbeing and empowers a nation. All these solely represent one thing : 'MORALS'

Indeed Thomas Jefferson is correct to say —

"Money, not morality, is the principle commerce of civilised nations."

How the topic: 'Morality and professions' could be free from confrontations and criticisms?

The very first accusation is that morality is theory and philosophy, so how can it have a place in professions which involve practicality day in and day out?

Many argue that moral theory is not something that many people find useful in everyday life. Theory, by its very nature, seems detached and somewhat irrelevant to practical decision-making. Hence, many people probably suspect that moral theory is something for academics to argue about: interesting for philosophers, psychologists and sociologists, but of little use for the average person. From this point of view moral theory is, at best, a generalisation about ordinary values and practical situations.

These arguments can well be confronted.

"Morality is an informal public system applying to all rational persons, governing behaviour that affects others, and has the lessening of evil or harm as its goal."

It has to be understood that morality is based on rationality and this can be explained through the following –

"If we analyse the behaviour of a truly rational man, we are sure to find a number of qualities in him which will prove to be moral. To be rational, for instance, is not to be partisan, or to have prejudices, or to be swayed by passions or self-interest, or to falsify truth, or to have double standards, but is to stand for truth under all conditions. These are moral qualities. In fact, to be rational is to be moral, and to be completely rational is to be completely moral"[5]

Moreover, it is already seen that how morality is the second word for success and progress which prove that morals do work in the practical world of a profession.

The second criticism is that "Saying is easier than doing" and that in reality it is difficult to practice morality always.

Consider this – Does being moral require more efforts than those involved in planning and thinking of evil ideas and work place politics and then carving out ways to escape from the allegations? Is it more painful than undergoing through psychological turbulence on doing something immoral? Definitely not! As already seen morality is a human behaviour which should be backed by virtues, keeping in regard the fact of the existence of the conflicts mentioned earlier. It may so happen that acquiring those values takes a little while, but it is not impossible. Being moral is effortless once

4 Daniel Friedman, Morals and Markets, Palgrave Macmillan, 2008, p.85

5 Words of Prof. S.K. Saksena quoted by Prof. S. Cromwell Crawford, The Choice Is Yours, Illustrations by Lilia Lender, Central Chinmaya Mission Trust, p. 95

the right kind of attitude and thought process is developed.

Now the question comes whether perfect morality in profession can be achieved?

Primatologist Frans de Waal in his work Our Inner Ape has quoted –

"Being both systematically more brutal than chimps and more empathic than bonobos, we are by far the most bipolar ape. Our societies are never completely peaceful, never completely competitive, never ruled by sheer selfishness, and never perfectly moral."

This means we can definitely reach near perfect morality if not perfect morality. So, even if "perfect morality" might be a little longer journey, we all as professionals can strive to achieve "near perfect morality".

One can inculcate moral behaviour in a profession through ethical decision making and ethical codes, through fighting for transformations or reforms wherever required, through open discussions regarding conflicts between morals and professional ethics and through imbibing the spiritual teachings.

Ethical decision making involves four distinct psychological processes: moral sensitivity, moral judgment, moral motivation/intention and moral character/intention.[6]

There should be moral sensitivity i.e. ability to recognise that a situation contains a moral issue. Next comes moral judgment which refers to formulating and evaluating which possible solutions to the moral issue have moral justification. Moral motivation or moral intention refers to the intention to choose the moral decision over another solution representing a different value. Moral courage or moral action refers to an individual's action in the situation. This step involves courage, determination, and the ability to follow through with the moral decision. Knowing the specific characteristics of a moral issue significantly influences the process of ethical decision making which can help individuals focus on and ask questions about important aspects of the moral issue, allowing them to gather critical information that will help them more thoroughly assess a moral dilemma.

Ethical codes are another way to inject moral and ethical concepts into professional thought and practice. Thus, a professional code must be one rooted in moral philosophy. A code may be seen as a voluntary contract between a professional and his/ her profession, a client or employer, or the appropriate publics. The purpose of the contract is to make the expectations of non-professionals and the 'promises' of the members of a profession explicit. Codes act as a tool for self-regulation and a professional body develops a code so as to establish itself as a moral entity.

"…….attempts should be made by the professional institutions to recognise the constraints and opportunities faced by professionals in attempting to „live right in an amoral world".[7]

If it is clear that business – or education, art, science, medicine, etc – is a professional calling that requires success within certain limits, just as, indeed, all life does, ethical business can make clear sense. It will not include, for example, trying to profit from deeds that are unethical, since profit itself will have to be understood as meaning prosperity that is productive, not destructive.

We need to ground the profession's skills and knowledge in its values of human dignity, service to humanity and social justice. We must bring to light and discuss openly in an effort to understand the deeper moral issues that underlie them. Through this basic tenets of profession will be heightened.

6 Sarah Hope Lincoln and Elizabeth K. Holmes, Ethical Decision Making: A process Influenced by Moral Intensity, Journal of Healthcare, Science and the Humanities, 2011, Vol I, No. 1, p. 57

7 Sue Hendler, Moral Theories in Professional Practice: Do they make a difference?, Environments 20(3), p. 27

Work is considered as a measure of success and the one which leads to self-actualisation and well being. Professions are riddled with complexities and ethical conflicts that obstruct the goal of meaningful work. The jobs are fraught with moral ambiguities and dilemmas; these become sources of frustration. What is needed is a transformation, a renewal of professional lives and the institutional contexts in which the profession operates, to humanize the alienating aspects of work and professions. Respecting the conscience rights of professionals is important for the moral integrity both of the practitioners concerned and of the profession itself. To confront these ethical dilemmas the organisation or the professional institution can play a major role by holding discussions and debates on the matters which lead to moral and ethical conflicts and coming up with a coping mechanism or other form of solution.

One needs to build that confidence to embark on a journey that seeks to transcend the complexities of professional life, and courage to transform the negative features of workplaces and organisations through reasoned moral action, moral imagination, and leadership.

Professionals must remember that goals of any profession are truth and justice, and procedures are but means to these ends.

"It should be remembered that their profession is not merely commercial or pecuniary in its concernments; it is intellectual and moral; it affects not only the interests but the virtues of the people."[8]

There are laws to punish professionals if they carry out certain professionally unethical conduct. But this is not possible in case of moral values. One cannot be prosecuted for not being humble or for not being empathetic while practicing profession. Here, self introspection plays an important role.

It is unconceivable to think about imbibing morality without learning what spirituality has to say.

Without moral and spiritual values, life is which has cultivated only material pleasures and harvested egotism, vanity, greed and hate.

Eknath Easwara, a spiritual teacher, has given two motives behind work.

Life, in which work is seen only as a way to support ourselves and our families, is what Eknath Easwara calls as 'labour camp'.

Whereas other school of thoughts seeks work as an opportunity or a process by which we can learn how to give of our self. People with this ideology offer their efforts to the commonweal. To them salary is of secondary importance and their real reward grows out of what they are able to add to the happiness and welfare of other human beings, whether in goods or services.

It is for us to decide what we want: Ephemeral joys or immortal bliss.

Nowadays Philanthrophy, Corporate Social Responsibility and Corporate Governance have been given tremendous importance. Aren't these rooted upon morality? It is expected of the professionals and the other rich business classes to give because they have.

It is said —

"Let the rich satisfy the poor, and keep in view the long pathway. Riches come now to one, now to other, and, like the wheels of cars are ever turning."

Dynamism is prerequisite for success in any profession. Dynamism is generated when we discover for ourselves a goal and dedicate ourselves to it with reverence and love.

Philosophy of Vedanta as explained by Swami Chinmayananda states that —

Instead of directing dynamism for constructive purposes, it is misspent, dissipated and wasted in unproductive channels. This occurs when the individuals have no spiritual goal, no noble idea

8 R.L. Dabney, Morality of the Legal Profession, p. 220

to strive for and no chosen field of endeavour. If, however, they can gear up their faculties and utilise them to achieve a noble goal, they too can develop into great men of achievement.

Odds are a way of life as the pleasures. Positive attitude and determination helps one face the most difficult situation in life. Thus, difficulties in personal life are not a permit to the professionals or rather any individual to misuse the authority or power conferred upon them.

"To face problems dynamically and to act diligently is any day nobler than escaping passively from the problems and retreating into a hole of bitterness, self-reproach, and self-condemnation."[9]

Professional life offers the hope of rewarding work, not just financially but work that is fulfilling. It must be remembered that the profession one enters into will provide an opportunity for self-actualisation rather than a mere means of survival.

If one understands that the human being has a self that can flourish only by being empathetic to the world, including other people, a self-enhancing moral code will leave plenty of room for generosity, kindness, compassion, without being self-sacrificing, self-denying

"The desire to conquer, so vehemently stimulated by the forensic competition, will almost surely seduce even the scrupulous conscience to transgress."[10]

We need to conquer, through the weapon of strong moral values and courage, this desire trying to overpower us by depriving us of the power of conscience.

Once morality is recognised as life enhancing, it is not going to be very difficult to champion it among our professions.

Indeed to any profession, what are intrinsic are the moral values, the foundation upon which it stands undeterred. Moral behaviour is not just an obligation on the part of the professionals but also a tool for them to succeed eternally and then material well being follows. But what needs to be remembered is that the primary object should be of selfless service backed by morality and ethical behaviour. As a professional we need to look beyond ourselves, understand our role in the bigger context of the society and nation whom we influence. Clinging to the right path always, we must confront all the obscurities and challenges through grit and firm determination.

Most importantly, we are humans beyond being professionals. So, morality in life, through spirituality, self awareness and transformation of attitude, would mean morality in profession.

One can begin with being moral in profession by avoidance of personal use of resources at office, using references for job as least as possible first depending upon the qualifications, trying to inculcate honesty in each of the task one does or the decision one takes, respecting those around, aiming towards customer satisfaction and shunning customer deceit, then, taking care that one's individual profit motive is not contradictory to societal well being and so on. Does practicing profession and morality hand in hand seem so difficult even now?

So, yes! We need to sit back and introspect as professionals upon morality because now it is understood that morals are not mountains that we are required to move and that they do affect us in our profession in a big way!

For fulfilling this, every professional must take an oath,

The oath of Profession —

O my inner self,

I realise your strength,

I understand my responsibilities,

I am acquainted with my powers.

9 The Choice Is Yours, The Choice Is Yours, Illustrations by Lilia Lender, Central Chinmaya Mission Trust, p. 86

10 R.L. Dabney, Morality of the Legal Profession, p. 226

O my inner self,
Always be as steady as those mountains,
During difficulties and odds,
Because challenges are but to face.

O my inner self,
I promise to serve selflessly,
I promise through morals I will never forget humanity.
Never through my deed will I let thee suffer
Through a guilty conscience.
That success for me always would mean
Inner peace and eternal fulfilment.

O my inner self,
Now I am relieved,
Relieved of all my fear
For my goal is not survival
But life with immortal bliss!

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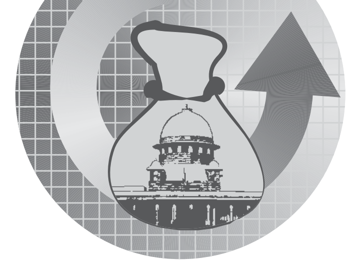

B.V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

Contributions made directly to LIC Group Gratuity Fund is eligible for deduction u/s. 36(1)(v) of the Act

CIT vs. M/s. Textool Co. Ltd. (Civil Appeal No. 447 of 2003) dated 9th September, 2009

For A.Y. 1983-84 the assessee claimed deduction of an amount of ` 50 lakhs as the initial contribution and an amount of ` 5,84,754/- as the annual premium paid to the LIC pursuant to the Group Gratuity Life Assurance Scheme framed by the LIC for the benefit of the employees of the assessee. The Assessing Officer disallowed the said amount on the ground that payment towards the gratuity fund was made by the assessee directly to the LIC and not to the approved gratuity fund of the assessee company.

On appeal, the Commissioner (A) observed that the contribution made by the assessee directly to the LIC was credited by the LIC to the Group Life Assurance Scheme for the exclusive benefit of the employees of the assessee under the policy issued by it.

Both the Tribunal and the High Court dismissed the appeal of the Revenue.

Before the Hon'ble Supreme Court the Revenue submitted that the provisions of section 36(1)(v) of the Act have to be construed strictly and for claiming deduction, conditions laid down in section 36(1)(v) of the Act must be fulfilled. The Hon'ble Supreme Court observed that though a fiscal statute is to be construed strictly and nothing should be added or subtracted to the language employed in the section, yet a strict construction of a provision does not rule out the application of the principles of reasonable construction to give effect to the purpose and intention of any particular provision of the Act. Their Lordships also observed that the real intention behind section 36(1)(v) of the Act, is that the employer should not have any control over the funds of the irrevocable trust created exclusively for the benefit of the employees. It was held that as the assessee had absolutely no control over the fund created by the LIC for the benefit of the employees of the assessee and further all the contribution made by the assessee in the said fund ultimately came back to the assessee's Employees Gratuity Fund, approved by the Commissioner with effect from the following previous year, the conditions stipulated in section 36(1)(v) of the Act were satisfied.

During the period when the interim order was in force, the assessee cannot be treated as an assessee-in-default for not deducting TDS and further not liable to pay interest for the said period u/s. 201(1A)

***Regional Director, ONGC Ltd. vs. Association of** Scientific and Technical Officers, ONGC Ltd. [(2013) 354 ITR 156, SC]*

An Association of Scientific and Technical Officers of the Oil and Natural Gas Corporation Ltd. (for short "the ONGC") filed a writ petition before the High Court, challenging the validity of the rule 3 of the Income-tax Rules, 1962, amended by the Income-tax (Twenty-second Amendment) Rules, 2001, wherein the method of fixation of the value of "perquisites" under section 17(2) of the Income-tax Act, 1961 (for short "the Act") was also amended.

The High Court granted the interim prayer that the ONGC could not deduct tax on the value of the perquisites mentioned in section 17(2)(ii) of the Act and therefore, 10% of the salary of employees of the ONGC in cities having population exceeding four lakhs as per the 1991 census was not included in the "salary" for the purpose of computing the tax that is deductible from the income of the employees for making payment to the Income-tax Department.

However, at the time of final hearing on 15th March, 2010, the said writ petition was dismissed by the High Court in view of the decision of the Hon'ble Supreme Court in the case of *Arun Kumar vs. Union of India [2007] 1 **SCC 732***, wherein, the validity of the amended rule 3 of the I.T. Rules was upheld and the method of valuation of perquisites provided in the amended rule 3 was also held valid. It was also observed by the High Court that the interim order passed in the writ petition shall automatically come to an end and the ONGC shall be liable to quantify the tax liability equivalent to the amount of TDS which was deductible and payable to the Department within three months from the date of receipt of the impugned order and in the event of compliance with this direction of the High Court, none of the employers shall be treated as an assessee in default.

Rejecting the contention of the ONGC that it was not liable to deduct the tax u/s. 192(1) of the Act, the Hon'ble Supreme Court observed that by the interim order of the High Court the ONGC was prevented to deduct tax, however, when the writ petition was dismissed by the High Court, the parties were put back in the same position as they were before the interim order was passed by the High Court in accordance with the provisions of section 144 of the Code of Civil Procedure.

It was held by their Lordships that for the period in which interim order was in force the ONGC cannot be deemed to be an assessee in default and therefore, the provisions of section 201(1A) of the Act for payment of interest by an assessee in default under the provisions of the Act will not be applicable to the payments not made by the ONGC.

Further, the Hon'ble Supreme Court observed that the High Court had directed the ONGC to quantify the tax liability equivalent to the amount of TDS which was deductible and payable to the Income-tax Department and remit the same to the Income-tax Department within three months from the date of the receipt of the copy of the impugned order. In the impugned order, the High Court also observed that in the event of compliance with the said direction, the ONGC shall not be treated as an assessee in default.

By the subsequent orders, the High Court appears to have extended the time by another three months for compliance with the said directions. However, the ONGC did not comply with the said directions of the High Court even within the extended time. The consequence would, therefore, be that the ONGC is deemed to be in default with effect from March 16, 2010, and it is liable to pay interest with effect from March 16, 2010, in accordance with the provisions of section 201(1A) of the Act as an assessee deemed to be in default.

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DIRECT TAXES
High Court

Reported

1. Income – Non-resident – Reimbursement of travel expenses of technicians deputed to India – Not income – A.Y. 1998-99

DIT vs. Krupp Udhe GmbH [2013] 354 ITR 173 (Bom.)

The assessee had sold compressor for ammonia storage tanks to an Indian firm. The compressors were facing some problems, and therefore the assessee had deputed two technicians to rectify the problems. For which the Indian company paid inspection technical fees and reimbursement of travel expenses. The AO assessed the reimbursement of expenses as income of the assessee. The CIT confirmed the order of the AO. The Tribunal decided in favour of the assessee. On appeal to the High Court by the revenue, the High Court while dismissing the appeal held that though there were conflicting decision of various High Courts, held that decision in favour of the assessee should be followed by placing reliance on the decision in the case of *CIT vs. Vegetable Products Ltd. 88 ITR 192 (SC)*, and therefore such receipt of reimbursement of travel expenses does not amount to income.

2. Sec. 37(1) registration of expenses for marketing products in foreign countries – Allowable as revenue expenditure – A.Y. 1999-2000

CIT vs. Torrent Pharmaceuticals Ltd. (2013) 87 DTR (Guj.) 54

The assessee had incurred registration expenses for the purpose of exporting and marketing its own products in foreign countries, the AO disallowed the same as being capital in nature. The CIT(A) and Tribunal held in favour of the assessee. On Appeal to the High Court by the Department, the High Court while dismissing the appeal held that expenses incurred for registration in foreign countries for the purpose of promotion and marketing of the assessee's products in those countries, and therefore held that the same was in the nature of revenue nature and held allowable as business expenditure.

3] Sec. 80-IA – profits and gains derived from industrial undertaking – Freight subsidiary – Not income derived from business of the industrial undertaking – No eligible for deduction u/s 80-IA.

Alpine Industries vs. Income Tax Officer (2013) 88 DTR (HP) 124

The assessee had received freight subsidy, which was granted to the industry, and the assessee while computing its deduction u/s.80-IA included receipts received under this subsidy granted by the Government. The AO excluded this receipt while

computing the deduction u/s.80-IA on the ground that it was not income derived from industrial undertaking. On appeal to the High Court, the High Court while dismissing the appeal held that freight subsidy granted to an industry cannot be held to be income derived from the business of Industrial Undertaking and cannot be included in the profits eligible for deduction under section 80-IA.

4] Sec. 32AB – Income from other sources or business income – Interest on margin money deposited for availing bank guarantee for conducting its business – Interest earned on such deposit is business income and eligible for relief under sec. 32AB

CIT vs. K & Co. (2013) 88 DTR (Del.) 166

The assessee had deposited certain funds with bank as margin money in order to obtain bank guarantee required by the State Government of Sikkim for the purpose of enabling the assessee to carry on the business of printing of lottery tickets and for conducting lotteries on behalf of the State Government of Sikkim. The interest earned on these deposits were held to be business income by the assessee and claimed deduction u/s. 32AB. The AO held that the interest earned is to assessed under the head Income from other sources. The High Court while dismissing the department's appeal held that the interest earned by the appellant on such deposits was inextricably linked with the assessee's business hence constituted business income eligible for relief u/s. 32AB.

5. Chartered Accountants Act – Sec. 8, 20 – Involvement of a person in an offence of bigamy comes within purview of 'moral turpitude'; such a person attracts disqualification to be a member of the Institute of Chartered Accountants of India

P. Mohanasundaram vs. President, Institute of Chartered Accountants of India [2013] 33 taxmann.com 80 (Madras)

The question of law involved in this case was whether professional body like the Institute of Chartered Accountants of India has any jurisdiction to go into the family matters between the husband and wife, entered by the husband being Chartered Accountant into any bigamous marriage. Dismissing the appeal of the appellant the court held that sections 8 and 20 of Chartered Accountants Act and Regulation 18 of Chartered Accountants Regulations, 1988 amplifies the disqualification of persons involved in an offence of moral turpitude, either to become a member, or continuing as a Member of the Chartered Accountants Council. The court held that the appellant and his estranged wife were Hindus, governed under the provisions of the Hindu Marriage Act, 1955. Section 17 of the Act states that marriage between two Hindus is void if two conditions are satisfied, viz., (1) the marriage is solemnised after the commencement of the said Act, and (2) at the date of such marriage, either party had a husband or wife living and the provisions of sections 494 and 495 shall apply accordingly. Thus, it was evident that if a Hindu marries with a person having a spouse living or he or she have a spouse living, marries any person, shall be liable for bigamy. Similar provision is provided by rule 23(1)(a) of the Central Government Civil Services Conduct Rules, 1964. Such provisions were made in accordance with the personal law applicable to the parties in order to maintain morality in society. The Hon'ble court relied on the decision of Supreme Court in the case of *Sushil Kumar Singhal vs. Punjab National Bank [2010] 8 SCC 573* wherein the court considered the meaning of moral turpitude and held that moral turpitude means anything contrary to honesty, modesty or good morals. It means vileness and depravity. In fact, the conviction of a person in a crime involving moral turpitude impeaches his credibility as he has been found to have indulged in shameful, wicked and base activities. The court held that having regard to the

fact that the appellant married another woman while the first marriage was subsisting, and had acted contrary to the law & to his 'estranged wife'; it was held that the offence of bigamy is coming within the meaning of 'moral turpitude' and no interference was required as the appellant has attracted disqualification by operation of law viz., section 8 of Chartered Accountants Act, 1949, due to his involvement in an offence involving moral turpitude.

6. Sec. 40(a)(ia) – No disallowance of freight charges is warranted for non-deduction of TDS when assessee had already filed Form 15J

Commissioner of Income-tax-Iv.Gurvinder Transport[2013] 34 taxmann.com 125 (Gujarat)

Assessee was a transporter who had taken services of various small truck owners. The freight charges were paid to them without deduction of TDS under section 194C and Form No. 15J was submitted. The Assessing Officer held that payment of transportation charges incurred by the assessee required deduction of tax at source since necessary requirements of declarations and filing of Form 15-J were not fulfilled. He made disallowance under section 40(a)(ia). The Commissioner (Appeals) confirmed the said disallowance. However, the Tribunal noted that the assessee had filed copy of 15-J form with the Assessing Officer who had not doubted the payment of freight charges as non-genuine and he deleted the said disallowance. On appeal in Tribunal, the Tribunal held that the revenue itself had contended that there was no 'J' form available with Commissioner–II, Baroda whereas the assessee's jurisdiction to file 15-J form was with Commissioner–I Baroda. Further, the Tribunal has recorded that during the course of the assessment proceedings, assessee had filed copy of 15-J form with the Assessing Officer who had not doubted the payment of freight charges as non-genuine. The Tribunal also appreciated the argument of the assessee that the assessee is a transporter who had taken services of various small truck owners and freight charges were paid to them. In view of such facts, the Tribunal allowed the appeal of the assessee. On further appeal in High Court, the High Court affirmed the findings of Tribunal and dismissed the appeal of revenue.

7. Sec. 194B – Writ petition on applicability of section 194B to payments made towards horse racing stake money – Writ Petition not maintainable being premature when other avenues of appeal are available to assessee

Hyderabad Race Club vs. DCIT [2013] 34 taxmann.com 126 (Andhra Pradesh)

The petitioner was carrying on the business of horse racing.The Deputy Commissioner by the impugned order treated the petitioner as an assessee in default under section 201(1) for not making TDS under section 194B in respect of the payments made as stake money to the horse owners. On a writ in High Court, the Hon'ble High Court dismissed the appeal of the assesse and held that it is only for the appellate authority to determine on examination of the record and on appreciation of the documents produced by the petitioner, whether the Deputy Commissioner has exceeded its jurisdiction in holding the petitioner as a defaulter assessee. That being so, the error of jurisdiction which the Deputy Commissioner has allegedly committed in passing the impugned order is not a mere error apparent on the face of the record which can be corrected under Article 226 of the Constitution of India. Hence, if aggrieved, the petitioner has to pursue the remedy of appeal available under the statute, but it cannot straightaway invoke the jurisdiction of the High Court under Article 226 of the Constitution of India. The court also held that pending an appeal under section 246A the Assessing Officer in exercise of powers conferred under section 220(6) may treat the assessee as not being in default even

though the time for payment has expired as long as such appeal remains undisposed of. The court held that the efficacious provisions were available under the Act to safeguard the interest of the assessee even during the pendency of the appeal against an order made under sections 201(1) & 201(1A). In case the petitioner's request for such protection was not considered or rejected by the Assessing Officer, probably a writ petition can be maintained by the petitioner for redressal for its grievance. However, such a stage has not yet come. For the aforesaid reasons; Court held that the writ petition at this stage cannot be entertained. Accordingly, the writ petition was dismissed at the stage of admission leaving it open to the petitioner to pursue the remedy of appeal available under the statute.

8. Sec. 47 – Whether conveyance of immovable property by a General Power of Attorney constitutes transfer of capital asset

Pace Developers & Promoters (P.) Ltd. vs. Government of NCT [2013] 33 taxmann.com 99 (Delhi)

The petitioner company entered into a collaboration agreement with 'R', owner of an immovable property, who executed a General Power of Attorney (GPA) in favour of the assessee. The GPA was duly registered and stamped. 'R' also executed a will, as per which 25 per cent of the land on which the said property was built, was to devolve on the director of the petitioner company on her death.The Divisional Commissioner, Government of NCT of Delhi (respondent) issued a circular, which is claimed to be contrary to the judgment of the Supreme Court in the case of *Suraj Lamp & Industries (P.) Ltd. vs. State of Haryana [2012] 340 ITR 1/[2011] 202 Taxman 607/14 taxmann.com 103* by the assessee. The assessee filed instant writ petition requesting the Court to direct the sub-registrar to register the GPA. The respondents claimed that the transaction between assessee and 'R' was entered into to evade stamp duty and it was in effect, a transaction of sale; rate of stamp duty being 6 per cent and not 3 per cent. Therefore, there was resistance by the Sub-Registrar to register the document. The court held that no order was passed by the respondents refusing registration of any document. The concern of the respondent was whether the transaction was not genuine, or not was not borne out from any order of the respondents. What the Court called upon to examine was the validity of the circular dated 27-4-2012. The court held that from the bare reading of the circular showed that the respondents has issued across the board, a directive to all Registrars and Sub-Registrar not to register any conveyance vis-à-vis an immovable property which was based on a GPA, Will or Agreement to Sell. This direction clearly misconstrues the observations of the Supreme Court in the case of Suraj Lamp & Industries (P.) Ltd. (supra), wherein the Supreme Court has not said that in no case a conveyance can be registered by taking recourse to a GPA. The court also held that as long as the transaction was genuine, the same will have to be registered by the Sub-Registrar. There was distinctly a specific reference to the fact that, a person may enter into a development agreement with a land developer or builder for development of a parcel of land or for construction of apartments in a building, and for this purpose, a power of attorney empowering the developer to execute sale agreements can be executed. The court further held that the directions contained in the impugned circular dated 27-4-2012, were quite contrary to the observations made by the Supreme Court in Suraj Lamp & Industries (P.) Ltd. (supra). Accordingly, the same was set aside. The court directed that it was open to the respondents to examine the genuineness of the transactions which were reflected in the document(s) filed, at the time of registration of conveyance and further held that in case, the Sub-Registrar comes to a conclusion that the transaction is not genuine, as would be expected, he would call upon the persons/entity presenting the document(s) to explain their case and, thereafter, if not convinced, pass a speaking order as to why the documents is/are not liable to be registered.

Un-reported

9. Sec 37 – Business expenditure – Provision towards non-performance guarantee – Allowable

FL Smidth Minerals Pvt. Ltd. vs. DCIT Order dated 3rd June, 2013. TCA 38 of 2010. (Madras High Court)

The assessee claimed deduction of provision non-performance guarantee to the tune of ` 40 lakhs. The AO disallowed the same on the ground that the same amounted to contingent liabilities. The assessee contended that this provision was nothing but non performance guarantee and was in the nature of warranty. It was further contended that the same was made on scientific basis, after considering earlier experience(s), nature of the contract and the likelihood of claims, etc. Accordingly it was contended that the provision was eligible for deduction. HELD that the assessee was entitled for deduction of this provision (viz. non performance guarantee) since it was in the nature of warranty. Ratio in *'CIT vs. Rotork Controls India Limited 314 ITR 62 (SC)'* followed.

10. Section 37 – Business expenditure – Payment to NSDL as 'custodian charges – Allowable as revenue expenditure

CIT vs. Infosys Technologies Ltd. ITA/1192 of 2006 Order dated 22nd April, 2013 (Karnataka High Court)

The assessee paid ` 44.43 lakhs to National Security Depository Limited (NSDL) which was a 'one time' custodian charges for shares pursuant to dematerialisation of shares. The assessee had taken over the liability of payment as one time custody charges. The said expenses were claimed as deduction. According to the AO, the assessee had paid the said amount as a goodwill measure and in any case the expenditure was in the capital field as the assessee derived an enduring benefit and therefore, the same was not allowable as deduction u/s 37(1). Held, that the test of enduring benefit is not conclusive. Without making of such payment, the assessee could not have made any issue of shares/securities. Hence an obligation was cast on the assessee to enter into an agreement with the depository for dematerialisation of securities and consequently to pay such custodian charges. Accordingly, it was held that the expenditure had been incurred in the normal course of business. Mere fact that the share holders have also benefitted from the payment will not disentitle the assessee from claiming the expenditure.

11. Sec 36(1)(iii) – investment in mutual funds – assessee having sufficient own funds – no disallowance can be made on account of interested paid on borrowed capital.

CIT vs. Mahanagar Gas Ltd.. ITXA No. 1978 of 2011 Order dated June 10, 2013. (Bombay High Court)

Investment in mutual funds from out of common fund comprising interest bearing as well as non-interest bearing funds. Held that when non-interest bearing funds (i.e., own funds) were sufficient to cover the investment in the mutual fund, a presumption arises in favour of the assessee that investment is made out of own (viz. non-interest bearing) funds and hence no disallowance is called for. Ratio in Reliance Utility and Powers Limited 313 ITR 340 (Bom.) followed.

12. Sections 22 & 28 – Business Income or House Property – Rental income from unsold flats of builder/developer – Assessable as Income from House Property

New Delhi Hotels Ltd. vs. ACIT ITA Nos. 238, 239 & 240/2013. Order dated May 17, 2013. (Delhi High Court)

Rental income from unsold flats in the hands of builder/developer, which are shown as 'Business Assets', should be assessed under the head "Income from house property" and not as "Business Income".

{Author's Note: Similar view has been taken by the Hon'ble Bombay High Court in the case of Mangla Homes 182 Taxman 55 (Bom.)}

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DIRECT TAXES
Tribunal

REPORTED

1. Gift by relative of Karta to HUF – Section 56(2)(v) – Meaning of relative – Donor can be relative of individual or HUF – Gift received by HUF from any relative falls within the exception prescribed under section 56(2)(v) of the Act – A.Y. 2005-06

Harshadbhai DahyalalVaidhya (HUF) vs. ITO (2013) 88 DTR (Ahd.)(Trib.) 288

The assessee before the Hon'ble Ahmedabad Tribunal was Hindu Undivided Family. The assessee during the impugned assessment year has received gift from Shri Ishwarlal Ambalal Vaidhya. The Learned A. O. invoked the provisions of section 56(2)(v) of the Act and taxed the gift received by HUF under the head 'Income from Other Sources' for the reason that the definition appended below the section defines the word 'relative' which indicates that such relationship is applicable only to Individual and not to HUF. On appeal the First Appellate Authority confirmed the order of Learned A. O.

The assessee being aggrieved by the order of the Learned CIT(A) preferred an appeal before the Ahmedabad Appellate Tribunal.

Hon'ble Appellate Tribunal was pleased to allow the appeal of the assessee by holding that proviso to clause (v) of section 56 (2) applies to any sum of money received as a gift from a "relative" either by an individual or by an HUF and, therefore, a sum of money received as a gift by an HUF from any relative also falls within the exception prescribed in the proviso to section 56(2)(v) if the donor is a 'relative' as defined in the Explanation thereto.

2. Purchase cost – Section 54 of the Act – Expenditure incurred for making the house liveable – Same is eligible for benefit under section 54 of the Act. A.Y. 2007-08

Shrinivas R. Desai vs. ACIT [2013] 35 taxmann.com 170 (Ahmedabad – Trib.)

The assessee in this case has sold his house property and purchased a new house property. The assessee has incurred certain expenditure in the new house property for making the same liveable. The A.O. is of the view that the cost of improvement is to be allowed as a deduction in the hands of the transferor and not in the hands of the transferee. Accordingly, the Assessing Officer required the assessee to show cause as to why deduction claimed for cost of improvement not be disallowed. It was submitted by the assessee that "the cost of improvement, as per section 55(1) (b), in any other case, means all the expenditure of capital nature incurred in making any addition or alteration to the capital asset by the assessee,

after it becomes his property". However the A.O. observed that the assessee readymade property was purchased in May 2006 after selling his house in August 2006. This fact does not indicate that the house was not in a liveable condition at the point of time of purchase. The A.O. further noted that the expenses were incurred by the assessee till 31st March 2007, i.e. much after purchasing the house. The A.O., therefore, rejected assessee's claim for the cost of improvement in the new house property being taken into account for computation of section 54 benefit. The assessee being aggrieved, preferred an appeal before the Learned CIT(A), who had upheld the action of the A.O. and declined to interfere in the matter. The assessee being aggrieved by the order passed by the Learned CIT(A) preferred an appeal before the Hon'ble Ahmedabad Appellate Tribunal. The Hon'ble Tribunal was pleased to allow the claim of the assessee by observing that the cost of purchase under section 54 does include any capital expenditure incurred by the assessee on such property to make it liveable. As long as the costs are of such a nature as would be includible in the cost of construction in the normal course, even if the assessee has bought a readymade unit and incurred those costs after so purchasing the readymade unit – as per his taste and requirements, the costs so incurred will form integral part of the qualifying amount of investment in the house property.

3. Capital Gains – Section 54 and section 54F of the Act – Sale of residential house along with plot of land – Investment in single residential house – Exemption under section 54 and section 54F are allowable. A.Y. 2008-09

Venkata Ramana Umareddy vs. DCIT [2013] 88 DTR (Hyd.) (Tribunal) 33

The assessee during the year has transferred land a developer and also sold his flat and earned Long Term Capital Gain. The assessee has purchased a new house and claimed exemption under section 54 and section 54F of the Act. The A.O. denied the claim of the assessee on the ground that for claiming the exemption under section 54 and section 54F of the Act the assessee has to purchase two houses. On appeal the First Appellate Authority upheld the action of the A.O. The assessee being aggrieved by the order of the Learned CIT(A) preferred an appeal before the Hon'ble Hyderabad Appellate Tribunal. The Appellate Tribunal was pleased to allow the claim of the assessee by holding that assessee having sold one residential house coming under section 54 and plot of land coming under section 54F and purchased one residential house within time prescribed in terms of both sections 54 and 54F for a price much more than the aggregate of Long Term Capital Gains, Assessee is eligible for exemption under both section 54 as well as section 54F of the Act.

UNREPORTED

4. Re-opening of assessment – Section 147/148 of the Act – Re-opening on the basis of audit objection – Not justified. A.Y. 2002-03

Infrastructure Leasing & Financial Services Ltd. vs. DCIT [ITA No. 167and 223/Mum/2010; Order dated 3-7-2013.

The assessee filed its original return which was subjected to the scrutiny assessment under section 143(3) of the Act on 25-2-2005. While passing the Assessment Order, the A.O. determined the total income of the assessee at ` 90,48,86,939/- under the normal provisions and at ` 85,99,59,539/- under section 115JB of the Act. While passing order under section 143(3) of the Act, the A.O. made addition on account of leasing equalisation reserve to the total income of the assessee, while computing the income under the normal provisions of the Act, but while computing the book profit under section 115JB of the Act, he did not add the said amount. Similarly, provision for investment valuation was considered by the A.O. for computing income as per the provisions of section 115JB of the Act, but same was not considered for computing

income under normal provisions of the Act. Subsequently, A.O. reopened the case under section 147 of the Act as he was of the opinion that there were reasons to believe that certain income chargeable to tax had escaped assessment. The A.O. has passed the Assessment Order under section 143(3) r.w.s. 147 of the Act by making addition on account of provision for investment valuation and lease equalisation for the purpose of under section 115JB of the Act. The assessee being aggrieved preferred an appeal before the Ld. CIT(A) challenging the jurisdiction of the A.O. to issue notice under section 148 of the Act. However, the Learned CIT(A) dismissed the ground of the assessee and upheld the action of the A.O. in issuing the notice under section 148 of the Act. The assessee being aggrieved preferred an appeal before the Hon'ble Appellate Tribunal Mumbai. The Hon'ble Appellate Tribunal was pleased to quash the notice issued under section 148 of the Act and consequential reassessment order by observing that the assessing authority cannot keep improving his case from time to time and that the reassessment proceedings have to stand or fall on the basis of what is stated in the reasons recorded under section 148(2) and nothing more. Secondly, it can hardly be disputed that once the AO notices a certain claim made by the assessee in the return filed, has some doubt about eligibility of such a claim and, therefore, raises queries, extracts response from the assessee, thereafter in what manner such claim should be treated in the final order of assessment, is an issue on which the assessee would have no control what-so-ever. Whether the A.O. allows such a claim, rejects such a claim or partially allows and partially rejects the claim, are all options available with the A.O., over which the assessee beyond trying to persuade the A.O., would have no control whatsoever. Therefore, while framing the assessment, allowing the claim fully or partially, in what manner the assessment order should be framed, is totally beyond the control of the assessee. If the A.O. therefore, after scrutinising the claim minutely during the assessment proceedings, does not reject such a claim, but chooses not to give any reasons for such a course of action that he adopts, it can hardly be stated that he did not form an opinion on such a claim. The Hon'ble Appellate Tribunal has further observed that the reassessment proceedings were initiated by the A.O. after objections were received from the internal audit party. The items involved in the audit objections find place in the reasons recorded by the A.O. The role of the audit parties to point out of the factual mistakes and not to advise the A.O. on legal matters. Therefore, if an A.O., reopens the assessment on the legal advice of the audit party, it cannot be held forming of an independent opinion. Whether a particular item has to be added or not while computing the income under normal provisions or MAT provisions is an issue to be decided by the A.O. He is the only person to interpret the law pertaining to computation of income as per the provisions of section 115 JB of the Act. It is not the case that A.O. had not called for any details from the assessee in this regard. He analysed the pieces of information supplied by the assessee about both the issues and later on decided to assess the income in a particular manner. Hence, reopening of the assessment was based on change of opinion and therefore the notice issued under section 148 of the Act is without any jurisdiction.

5. Penalty – Section 271(1)(c) of the Income-tax Act, 1961 – Concealment of income – Revised return – After issuance of summons under section 131, assessee filed revised return declaring additional income – No penalty was imposable upon assessee under section 271(1)(c) of the Act. A.Y. 2008-09

Jaysukh M. Parmar vs. ACIT [I.T.A. Nos. 723 to 725 / Ahd. / 2012; Order dated. 12-10-2012]

The Assessing Officer ('A.O.') received information regarding the assessee having invested certain amount in a company. Accordingly, he issued notice under section 131 of the Act to the assessee. During the proceedings, assessee declared additional income by furnishing the revised return of income. The A.O. completed assessment accepting additional income and also imposed

penalty under section 271(1)(c) as according to him the declaration was not voluntary.

On appeal the Tribunal held that the revised return of income was filed by the assessee before the recording of the statement by the A.O. under section 131 of the Act. The revised return was filed immediately after the receipt of notice under section 131 of the Act asking the assessee to produce the copies of return of income and books of account. Thus, the notice under section 131 issued by the A.O. only required the assessee to furnish copies of the return of income filed by him for the assessment years 2007-08 and 2008-09 and other details for the period. In the said notice, there is no indication regarding any adverse material having brought out on record by the department regarding any concealment of income by the assessee. Further, the Tribunal noted that it is not the case of the A.O that the revised return of income was not filed by the assessee or that the same is not valid. In fact, the A.O. has noted in the assessment order that the assessee has filed his original return of income and thereafter revised return of income declaring additional income. Therefore, the penalty was liable to be deleted.

6. Deductions – Section 80-IB(10) of the Income-tax Act, 1961 – Profits and gains from industrial undertakings other than infrastructure development undertakings – A portion of plot area which is earmarked for laying roads, should be considered as part of housing project in order to determine the size of the plot of land under section 80-IB(10) of the Act. A.Y. 2008-09

Sigma Constructions vs. ITO [I.T.A. No. 364 / Hyd. / 2012; Order dated: 7-3-2013]

The assessee had undertaken the project of construction of residential complex on a plot of land admeasuring more that 1 acre and claimed deduction under section 80-IB in respect of its income from that project. The A.O. disallowed the claim of deduction on the grounds that as per approved municipal plan of the project after taking out the area earmarked for road, the total area of the plot was less than one acre.

On appeal the Tribunal held that as per provisions of section 80-IB(10) of the Act, the housing project should be on the size of a plot of minimum one acre. If the building project was sanctioned by the Municipal Corporation for developing the project in the area of 1 acre land or more, the assessee is entitled for deduction under section 80-IB(10). Thereafter, if a portion of the plot area is earmarked for roads after the assessee entered into development agreement and the plan was duly sanctioned by the competent authority, it is not the fault with the assessee as the same is beyond the control of the assessee. Thus, in such a case liberal interpretation of section 80-IB (10) is to be considered and the assessee should be allowed the deduction under section 80-IB(10) of the Act.

7. Business loss – Section 28(i) of the Income-tax Act, 1961 – Inter-corporate deposits ("ICDs") – Where investment in inter-corporate deposits was treated as part of business activities, the interest accrued therefrom had been treated as business income – Loss arising due to non-recovery of such investment was allowable as business loss. A.Y's. 2001-02 & 2002-03

Jindal Iron & Steel Company Ltd. vs. Dy. CIT [I.T.A. Nos. 6298 / Mum / 2009, 6677 & 7109 / Mum. / 2010; Order dated 31-10-2012]

The assessee had given ICDs in earlier years to the various companies. The interest accrued to the assessee was shown in the profit and loss account as business income. Subsequently, the depositee companies were not in a position to pay the amount due to financial crunch and in one time settlement proposal, settlement was reached where the parties paid part of the principal amount as full and final settlement. The balance amount was written-off in the books of account, this amount was on account of interest and partly towards the

principal amount. The interest amount written off was claimed as deduction under section 36(1)(vii) whereas the principal amount was claimed as business loss.

The claim of the bad debt and business loss of the assessee was negated by the A.O. and the CIT(A) on the ground that it was not the business activity of the assessee to make such deposits on systematic and regular basis, therefore, dealing in ICDs was neither the main business of the assessee nor incidental further, the assessee was also not a Non-Banking Financial Company.

On appeal as regards, the interest amount written off the Tribunal held that it is not disputed that in all the years, the assessee had shown accrued interest on ICDs in the profit and loss account and offered for tax as business income, which is accepted by the Department, therefore, once interest income has been taxed as business income, then it cannot be said that lending of money in the form of ICDs was not part of the business activity of the assessee. Thus, when the assessee has written off this amount as irrecoverable, the same has to be allowed as bad debt under section 36(1)(vii) read with section 36(2) of the Act as all the conditions laid down therein stands fulfilled. As regard the principal amount written off the Tribunal held that as investment in ICDs were part of the business activities of the assessee the loss arising on such investment is thus consequently allowable as business loss.

8. Depreciation – Section 32 of the Income-tax Act, 1961 – Licence to collect toll – Assessee capitalised costs incurred on development and construction of infrastructural facility – It claimed depreciation on amount capitalised – Held – Licence, being an intangible asset within meaning of section 32(1)(ii) – Assessee was eligible to claim depreciation. A.Ys. 2006-07 & 2007-08

ACIT vs. Ashoka Infraways (P.) Ltd. [I.T.A. Nos. 185 & 186 / PN / 2012; Order dated 29-4-2013]

The assessee was engaged in the business of construction, operation and maintenance of infrastructure facilities. The assessee was awarded an infrastructure work of development, operation and maintenance of infrastructure project of a road on Build, Operation and Transfer basis. It was required to develop, construct and maintain the road at its own cost for a specified period. On expiry of the specified period, the infrastructural facility was to be transferred to the State Government free of charge. In consideration of the expenditure incurred on construction, operation and maintenance of the road and handing it over to the State Government free of charge, the assessee was given a right to collect toll from the motorists using the road during the specified period. As the assessee had made huge investment in the development and construction of the infrastructural facility, it capitalised the costs incurred on development and construction of infrastructural facility and claimed depreciation on the amount capitalised on the ground that the right to collect toll obtained by it was akin to a license, being an intangible asset within the meaning of section 32(1)(ii).

The A.O. held that the right to collect toll was neither a license nor a valuable commercial or business right covered in the expression intangible asset for the purposes of section 32(1)(ii) and accordingly, disallowed the claim of depreciation.

On appeal Tribunal held that the right to collect toll is emerged as a result of the costs incurred by the assessee on development, construction and maintenance of the infrastructure facility. Such a right has to be in the nature of 'intangible asset' falling within the purview of section 32(1)(ii) and is eligible for depreciation under section 32 of the Act.

CA Sunil K. Jain

DIRECT TAXES
Statutes, Circulars & Notifications

Income-tax (Fourth amendment) rules, 2013 – Insertion of rules 6AAD & 6AAE and Form Nos. 3C-O & 3 CP

The Central Board of Direct Taxes made the following rules further to amend the Income-tax Rules, 1962, as the Income-tax (Fourth Amendment) Rules, 2013, which shall come into force on the date of their publication in the Official Gazette. In the Income-tax Rules, 1962, after rule 6AAC, the following rules have been inserted, namely:-

"6AAD. Guidelines for approval of agricultural extension project under sections 35CCC. 6AAE and conditions subject to which an agricultural extension project is to be notified under section 35CCC". Accordingly any expenditure incurred on the agricultural extension project which is reimbursed or reimbursable to the assessee by any person, whether directly or indirectly, shall not be eligible for deduction under section 35CCC and the assessee shall, on or before the due date of furnishing the return of income under sub-section (1) of section 139, furnish the prescribed information to the Commissioner of Income-tax or the Director of Income-tax, as the case may be, and if the Commissioner of Income-tax or the Director of Income-tax, as the case may be, is satisfied he may, after making appropriate inquiries, furnish a report on the circumstances referred to in clauses (a) to (e) to the CBDT for appropriate action as per the provisions of sub-rule (13) of rule 6AAD. In Appendix-II of the said rules, after Form No. 3CN, Form No. 3C-O being application form for approval under sub-section (1) of section 35CCC of the Income-tax Act and Form No.3CP being form for notification of agricultural extension project under sub-section (1) of section 35CCC of the Income-tax Act, 1961 have been inserted.

(Notification no. 38/2013 dt. 30-5-2013)

Income-tax (Fifth Amendment) Rules, 2013 – Amendment in rules 30, 31 & 31A and insertion of Form Nos. 16B & 26QB and substitution of Form No. 24Q – Simplification of procedure for deposit of tax and furnishing of information relating to Tax Deducted at Source (TDS) under section 194-IA (Payment on transfer of certain immovable property other than rural agricultural land)

Central Board of Direct Taxes made rules further to amend the Income-tax Rules, 1962, which may be called the Income-tax (Fifth Amendment) Rules, 2013 and shall come into force on the date of their publication in the Official Gazette. This will provide simplification of procedure for deposit of tax and furnishing of information relating to Tax Deducted at Source (TDS) under section 194-IA (payment on transfer of certain immovable property other than rural agricultural land) and revision of Form No. 24Q. In Appendix-II of the said rules after Form No. 16AA, Form No. 16B shall be inserted, for Form

No. 24Q, the new Form 24Q has been substituted and after Form No. 26QAA, the Form 26QB has been inserted.

(Notification no. 39/2013 dt. 31-5-2013)

Section 48, Explanation (v) of the Income-tax Act, 1961 – Capital Gains – computation of – notified cost inflation index for Financial Year 2013-14

The Central Government notified the cost inflation index for the F.Y. 2013-14

In the said notification, in the Table, after serial number 32 and the entries relating thereto, the following serial number and entries have been inserted, namely :-

Sl. No.	Financial Year	Cost Inflation Index
(1)	(2)	(3)
"33	2013-14	939"

(Notification no. 40/2013 dt. 6-6-2013)

Amendments in Rules 10A, rule 10AB, rule 10B, rule 10C, rule 10D, rule 10E and Substitution of Form No. 3CEB – Income-tax Rules 1962

In pursuance of the changes made by the Finance Bill 2012 bringing specified domestic transactions under the ambit of Transfer Pricing Regulations, CBDT has amended the format of Form 3CEB. The said notification amends Rules 10A, 10AB, 10B, 10C, 10D and 10E. The new format of Form 3CEB includes reporting on specified domestic transactions. Following are the additional reporting requirements in new format of Form 3CEB:

1. Nature of Business or Activity of the assessee (as per the Code for nature of business to be filled as per the instructions for filling form ITR 6;)
2. Aggregate Value of International Transactions as per books of account;
3. Aggregate Value of Specified Domestic Transactions as per books of account;
4. Particulars in respect of transactions involving guarantee;
5. Particulars in respect of international transactions of purchase or sale of marketable securities, issue and buyback of equity shares, optionally convertible / partially convertible / compulsorily convertible debentures or preference shares;
6. Particulars in respect of international transactions arising out / being part of business restructuring or reorganisations;
7. Particulars of any other transactions including the transactions having a bearing on the profits, income, losses or assets of the assessee;
8. Particulars of Deemed International Transactions;
9. Particulars in respect of Specified Domestic Transactions.

(Notification No. 41/2013-IT dated 10-6-2013)

Income-tax (Seventh Amendment) Rules, 2013 – Amendment in rule 12 & substitution of Forms ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 and ITR-7

The Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962, which may be called the Income-tax (Seventh Amendment) Rules, 2013 and shall be deemed to have come into force with effect from the 1st day of April, 2013.

It provides that where an assessee is required to furnish a report of audit specified under sub-clauses (iv), (v), (vi) or (via) of clause (23C) of section 10, section 10A, clause (b) of sub-section (1) of section 12A, section 44AB, section 80-IA, section 80-IB, section 80-IC, section 80-ID, section 80JJAA, section 80LA, section 92E or section 115JB of the Act, he shall furnish the same electronically." Further a person claiming any relief of tax under section 90 or 90A or deduction of tax under section 91 of the Act, other than a person to whom clause (aaa) or clause (ab) is applicable, shall furnish the return for assessment year 2013-14 and subsequent assessment

years in the manner specified. It provided further that a person who is required to furnish any report of audit referred to in proviso to sub-rule (2) electronically, other than a person to whom clause (aaa) or clause (ab) of the first proviso is applicable, shall furnish the return, in Form as applicable to him, in the manner specified in clause (ii) or clause (iii)."

In the said rules, in Appendix-II, for "Forms ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 and ITR-7", the new "Forms ITR-2, ITR-3, ITR-4, ITR-5, ITR-6 and ITR-7 " have been substituted.

Notification no. 42/2013 dt. 11-6-2013)

Section 90 of the Income-tax Act, 1961 – Double Taxation Agreement – Agreement for Exchange of Information with respect to taxes with foreign countries – principality of Monaco

An Agreement between the Government of the Republic of India and the Government of the Principality of Monaco for the exchange of information relating to tax matters has been signed at Monaco. Accordingly the date of entry into force of the said Agreement is the 27th day of March, 2013, being the date of later of the notifications of completion of the procedures required by the respective laws for the entry into force of this Agreement. Now the Central Government directed that all the provisions of the said Agreement, as set out in the Annexure thereto, shall be given effect to in the Union of India with effect from the 27th March, 2013.

(Notification No. 43/2013 dt. 12-6-2013)

Section 115 of the Finance Act, 2013 – Commodities Transaction Tax – Notified date for enforcement of Chapter VII of Finance Act, 2013

The Central Government has notified the 1st day of July, 2013 as the date on which Chapter VII of the said Act shall come into force (Notification no. 45/2013 dt. 19-6-2013).

Commodities Transaction Tax Rules, 2013 notified: The Central Government made the rules relating to commodities transaction tax, which may be called the Commodities Transaction Tax Rules, 2013 and shall come into force on the 1st day of July, 2013.

The said rules provide the definitions, list of Agricultural commodities for the purposes of clause (7) of section 116 of the Act, rounding off value of taxable commodities transaction, commodities transaction tax, etc. The value of taxable commodities transaction and the amount of commodities transaction tax, interest and penalty payable, and that the amount of refund due, under the provisions of Chapter VII of the Act shall be rounded off to the nearest rupee and, for this purpose, where such amount contains a part of a rupee consisting of paise then, if such part is fifty paise or more, it shall be increased to one rupee and if such part is less than fifty paise it shall be ignored.

The rules also prescribe details and procedure about the Payment of Commodities Transaction tax, Form No. 1 for Return of taxable commodities transactions. Return by whom to be signed; Time limit to be specified in the notice calling for return of taxable commodities transaction, Form No. 2 for Notice of demand, Prescribed time for refund of tax to the person from whom such amount was collected. Form No. 3 of appeal to Commissioner of Income-tax (Appeals). and Form No. 4 of appeal to Appellate Tribunal.

(Notification no. 46/2013 dt. 19-6-2013)

Standardising the process of filing application under section 10(46) of the Income-tax Act, 1961 – Re : specified income arising to a body or authority or Board or Trust or Commission

Under section 10(46) of the Income-tax Act, specified income arising to a body or authority or Board or Trust or Commission, established or constituted by or under a Central or State Act or by a Central or State Government with the object of regulating or

administering any activity for the benefit of general public, would be exempt from tax subject to the condition that the said entity is not engaged in any commercial activity. The entity eligible to claim tax exemption u/s. 10(46) is required to be notified by the Central Government in the Official Gazette.

At present, there is no uniformity in the manner in which applications under section 10(46) are being filed by applicants. In order to standardise the manner of filing application's under section 10(46) and to avoid procedural delay in processing the same applicants have been advised to file the applications along with requisite enclosures to the Commissioner of Income-tax/Director of Income tax under whose jurisdiction their cases fall. The applicants have further been advised to adopt the format laid down while submitting the applications u/s. 10(46) of the IT Act. The applicant shall also send a copy of the said application along with all its enclosures to the Under Secretary (ITA-l), Central Board of Direct Taxes, accompanied by the acknowledgement receipt forwarded as evidence of having furnished the application in the office of jurisdictional CIT/DIT.

Format of Application seeking notification u/s 10(46) has been prescribed in the said notification.

(Notification No. F. No. 196/6/2013-ITA-1-IT dated 24-6-2013)

Income-tax (Eighth Amendment) Rules, 2013 – Insertion of Rule 21AC and Form No. 10FC:

The Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962, which may be called the Income-tax (8th Amendment) Rules, 2013 and shall come into force on the date of their publication in the Official Gazette regarding matters of authorisation for claiming deduction in respect of any payment made to any financial institution located in a notified jurisdictional area.

(Notification No. 47/2013 dt. 26-6-2013)

Circulars

Acknowledgement by banks at the time of submission of form 15-G/15-H: The banks are not required to deduct TDS from depositors who submit declaration in Forms 15-G/15-H under Income Tax Rules, 1962. However, it was brought to notice that despite submission of Forms 15-G/15-H by customers, banks are deducting tax at source, at times, causing inconvenience to customers resulting in a number of complaints. Such instances arise because either the forms are misplaced or a track is not kept of forms received in the branches.

The matter has been examined by CBDT in consultation with Indian Banks' Association (IBA). With a view to protect interest of the depositors and for rendering better customer service, banks have been advised to give an acknowledgment at the time of receipt of form 15-G/15-H. This will help in building a system of accountability and customers will not be put to inconvenience due to any omission on part of the banks.

(Circular DBOD.no.leg.bc.100/09.07.005/2012-13, dt 31-5-2013)

Instructions / Press Release

Appointment of new Chairperson for CBDT: The President of India has appointed Senior IRS officer Sudha Sharma as the new Chairperson of the Central Board of Direct Taxes in the Finance Ministry. Sharma, a 1976-batch Indian Revenue Service officer, has been given the charge after incumbent Poonam Kishore Saxena retired.

She was till now serving as a member (Legislation and Computerisation) in the seven-member CBDT, which includes the Chairperson. The officer has served as Director General (Vigilance) of the I-T department in national capital before her appointment to the top body.

Sharma takes over the charge at a time when CBDT and I-T department have been tasked by government with a daunting job of collecting ` 6.68 lakh crore revenue for 2013-14, up from ` 5.65 lakh crore in the previous fiscal, (Order-Instruction - 127/2013 – dated – 14-6-2013).

CA Tarunkumar Singhal & CA Sunil Lala

INTERNATIONAL TAXATION
Case Law Update

A] HIGH COURT JUDGMENTS

I Section 9 – Business Connection – Assessee – foreign company's presence in India is limited to its liaison office which assist Indian manufacturers to manufacture goods according to specification for export to buyers in other countries (which are subsidiaries of assessee), Activities of non-resident assessee are confined in India to purchase of goods for export Income derived therefrom shall not be deemed to accrue or arise in India Entitled to exemption under Explanation 1(b) to section 9(1)(ii)?

CIT (International Tax) vs. Nike Inc. [2013] 34 taxmann.com 170 (Kar) – Assessment Years: 1999-2000 to 2006-07

1 The assessee, Nike Inc., a world known brand in sports apparels, having its main office in USA, opened a liaison office in India after obtaining necessary permission from the RBI. The assessee did not engage in any manufacturing activity by itself. It only carried out activities such as designing, marketing and distribution. It engaged various manufacturers all over the world on a job to job basis and the subsidiaries had to purchase the same directly from the manufacturers and make payment for the same.

2 The liaison office would only propose and give its opinion about the reasonability of the price and all related issues etc., the US office decided about the price, quality, quantity, to whom to be shipped and billed. The local manufacturer in India was conveyed of the decision by the office in USA and once it was accepted, the local manufacturer carried on his activity. The liaison office did not have any authority to conclude contracts and all its expenses were borne by the Head Office.

The Hon'ble High Court, held that no income accrued to the assessee in India. The object of establishing the said office was to identify the manufacturers, give them the technical know how and see that they manufacture goods according to their specification which would be sold to their affiliates. The person who purchased the goods paid the money to the manufacturer, in the said income, the assessee had no right. The said income cannot be said to be a income arising or accruing in the Tax Territories vis-à-vis the assessee. In fact, the evidence on record showed that Nike, USA bears the entire expenses of the liaison office.

The buyer who was a non-resident may in turn have paid some consideration to the assessee

outside India but such payment was pursuant to agreement entered outside India. Therefore, even if any income arose or accrued to the assessee, it was outside India. Explanation (1) to sub-section (2) of Section 5 expressly states income accruing or arising outside India shall not be deemed to be received in India within the meaning of the Section.

It held that the assessee did not have any business connection in India since it was not purchasing any goods it was only enabling manufacturers to purchase goods of a particular specification as required by the foreign buyer.

B) TRIBUNAL DECISION

Reimbursement of Expenses – Head Office Expenditure – No co-relation between the actual expenditure incurred by the HO and that recovered from branches also there is a profit element in recovery from the branches HO not merely recovered the costs incurred from the Indian branch Amount charged from the Indian branch can not be said to be reimbursement of expenditure Under the domestic law the principle of mutuality applies in respect of transactions between the permanent establishment and its head office – Whether Income & Tax Liability of the permanent establishment as per domestic law and the DTAA in respect of the PE would be only such which is more favourable to the assessee – Amount not chargeable to tax under the domestic law, the taxability of such amount cannot be examines under the DTAA- Held : No.

M/s LLOYDS REGISTER vs. DDIT 2013-TII-85-ITAT-MUM-INTL – Assessment Year : 2002-2003

i) There is no co-relation between the actual expenditure incurred by the HO and that recovered from branches and secondly, there is a profit element in recovery from the branches inasmuch as the actual expenditure of the HO is 32% whereas it has made recovery at the rate of 40% of gross income.

ii) It is not as if the HO is assisting the Indian PE in doing the part of the work done by them. To put it differently, the work of HO starts when the Indian branch office has completed its part of work. The HO is charging Indian PE with a profit element and further there is no correlation between the amount charged and that spent by the HO, it is incorrect to contend that there is reimbursement of actual expenses of the HO.

iii) The assessee is a non-resident governed by the provisions of the DTAA, it is entitled to the benefits of DTAA, if the quantum of income or the overall tax liability turns out to be less as per the DTAA vis-à-vis the domestic law.

iv) The Assessing Officer will compare the income of the permanent establishment as per domestic law and the DTAA. The liability to tax on the assessee in respect of the income of the PE would be fastened by only such of the two computations which is more favourable to the assessee as per the mandate of section 90(2) of the Act.

v) Once an amount is not chargeable to tax under the domestic law, there can be no question of examining the taxability of such amount under the DTAA. It goes without saying that the role of the DTAA is to reduce, if possible, the tax burden cast under the provisions of the domestic law. It is axiomatic that the DTAA cannot cast a fresh obligation of tax independent of any provision under the domestic law in this regard.

CA. Hasmukh Kamdar

INDIRECT TAXES
Central Excise and Customs – Case Law Update

Stay- Dispensation of pre-deposit

International Tobacco Co. Ltd. vs. Commissioner of Central Excise, Ghaziabad, [2013 (292) E.L.T. 263 (Del.)]

The facts in this case are as follows.

M/s International Tobacco Co. Ltd. [ITC] was engaged in the manufacture of cut tobacco and different brands of cigarettes. ITC availed CENVAT Credit on inputs, capital goods and input services in terms of the CENVAT Credit Rules, 2004. They were regularly receiving back from their own sales offices cigarettes which were not saleable in the market as the same was exuding bad smell and that the tobacco inside the cigarettes had dried up and, therefore, not fit for marketing. They had informed the Department from time to time by way of letters quantity of such non marketable cigarettes received from their sales office under the cover of Challans. They were also availing, in terms of rule 16 of Central Excise Rules, 2002, credit of duty paid on such returned cigarettes.

Department objected to their taking credit under Rule 16 on the ground that the ITC was receiving the so-called non-marketable/non-saleable cigarettes returned by their own sales offices only in order to enjoy the benefit of credit in terms of Rule 16 of the Central Excise Rules, 2002 which was not available to them. Show cause notices were issued proposing recovery of duty of ` 1,73,944/- and ` 6,81,54,095/- respectively under Rule 14 of the CENVAT Credit Rules, 2004 read with section 11A(1) of the Central Excise Act, 1944, together with recovery of interest under section 11AB ibid for taking inadmissible credit, and proposing penal action against the ITC.

The notices were adjudicated by the Commissioner who confirmed the demands raised in both notices, imposed penalty of equal amount, and ordered for recovery of interest. The ITC preferred an Appeal against the Order of the Commissioner, along with applications for waiver of pre-deposit and stay of recovery of the amounts in dispute.

After hearing the contentions of both sides the Hon'ble Tribunal observed as follows:

Rule 16(1) of the Central Excise Rules, 2002 provides that "Where any goods on which duty had been paid at the time of removal thereof are brought to any factory for being re-made, refined, reconditioned or for any other reason, the assessee shall state the particular of such receipt in his records and shall be entitled to take CENVAT Credit of the duty paid as if such goods are received as inputs under the CENVAT Credit Rules, 2002 and utilise this credit according to the said rules". In the face of the clear language of the above rule, the finding of the Commissioner that very first condition for eligibility of credit on returned goods is that the goods must be useable and used as inputs in

the manufacture of finished goods is prima facie not tenable. Further, in the present case, a large percentage of tobacco (obtained by ripping open returned cigarettes) is used along with fresh tobacco in the manufacture of fresh cigarettes. Thus, *prima facie*, the assessees are entitled to credit in terms of Rule 16 and the duty demand is *prima facie* not sustainable in the light of Rule 16 and in the light of the decision of the Tribunal in *Supreme Industries Limited vs. CCE, Chandigarh reported in 2005 (189) E.L.T. 453* and *Hindalco Industries Limited vs. CCE, Belapur reported in 2007 (215) E.L.T. 547.*

The Hon'ble Tribunal, therefore, waived the deposit of the duty, interest and penalty and stayed recovery thereof pending the appeals.

Duty free shops

CBEC has prescribed detailed procedure for movement of excisable indigenous goods to warehouse or retail outlets of Duty Free Shops appointed or licensed under Customs Act, 1962. This procedure prescribes for:

(i) registration of warehouse,

(ii) procedure in respect of excisable goods removed from a factory to warehouse of Duty Free Shop

(iii) restriction on removal of goods which are prohibited under ITC (HS)

(iv) demand of duty on goods not reaching destination

(v) procedure for transfer of goods from warehouse to retail outlet and sale therefrom

(vi) period of warehousing

(vii) duty leviable on goods not duly accounted for as having been sold in foreign currency to passenger going abroad or sold to passenger arriving from abroad.

[CBEC Circular No. 970/04/2013-CX, dated 23-5-2013. The Circular also prescribes various proformas and formats for the purpose of this procedure.]

REQUIRED

C.A's / MBA's
for Bank loan proposals.

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Rane (9821220665)

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INDIRECT TAXES
VAT Update

1. Amendment to Rate of Tax

Trade Circular No. 3T of 2013, dated 10-6-2013

The Commissioner of Sales Tax has issued above referred circular to explain changes in rate of tax made by amendment to Schedules appended to the VAT Act as well as amendments made to the notifications issued under schedule entries of the said schedules to give effect to State budget proposals.

2. Amendment to MVAT Act

Trade Circular No. 4T of 2013, dated 10-6-2013

The Commissioner of Sales Tax has issued above referred circular to explain changes made in provisions of MVAT Act by Maharashtra Act No. VIII of 2013, dated 20-4-2013, to give effect to State budget proposals.

Section 32A is inserted, by the said Maharashtra Act No. VIII of 2013, in the MVAT Act to provide for issue of demand notice by the Commissioner, where it is noticed by him that the dealer has, either fully or partly, accepted, the recommendation made by the VAT auditor to pay additional amount and the dealer has not paid it, within the prescribed period, may issue notice of demand to recover the said amount. In para 5 of the said circular, it is clarified by the Commissioner that provisions of newly inserted section 32A is procedural in nature, such demand notice may be issued for any pending period in respect of which the accountant has made the recommendations and dealer has accepted the said amount either fully, or partly.

3. Annual Return – VAT TDS – Form 424 – Rule

As per amended rule 40 from 1-5-2013, all employers, whether registered under the MVAT Act or not, who has deducted VAT at source from payment made to the contractor, is require to file Annual E return for VAT TDS in Form 424. The E-form 424 is available on the site of department mahavat.gov.in. The instruction sheet for filing of e-return 424, as displayed on the above website, is as under:-

INSTRUCTION SHEET

RD AND URD Employers have to file E-Return in Form 424 through Sales Tax website.

The procedure for filing E-Returns for RD Employers.

Download 424 Template from the Downloads.

- Fill the data in Form 424.
- Validate Form 424.
- Insert TIN as login ID & Password in user login menu.
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- The Procedure for filing E-Returns for URD Employers.
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- URD" from E- Services.

CA. Rajkamal Shah & CA. Naresh Sheth

INDIRECT TAXES
Service Tax – Statute update

1. Exemption and refund to SEZ units and developers

The Government has issued a new notification simplifying the procedures for exemption to a SEZ unit or a developer of SEZ on services used exclusively for authorised operations. It has also laid down the conditions for refund of service tax on specified services that are not exclusively used for authorised operation or where the SEZ unit or the developer has not claimed such exemption. This notification is issued in supersession of Notification No. 40/2012 – ST dtd. 20-6-2012. The details of the new notification is available on the website of the Chamber.

(Notification No. 12/2013 – ST dtd. 1-7-2013)

2. FTP related amendments with respect to scrips issued

The amendments are made in the Notification No. 6/2013 – ST dtd. 18-4-2013 in relation to certain categories of export which shall not be counted for calculation of export performance or computation of entitlement for the purpose of scrips issued in relation to the Foreign Trade Policy.

(Notification No. 11/2013 dtd. 13-6-2013)

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INDIRECT TAXES
Service Tax – Case Law Update

1. Services

Club or Association Service

1.1 Lote Parshuram Env. Prot. Co-op Society Ltd. vs. CCE, Kolhapur 2013 (30) STR 468 (Tri-Mum.)

In this case the appellant set up Common ETP for providing effluent treatment of their member industries. Out of total project cost 50% of the project cost was raised by the members for setting up the effluent plant and remaining by subsidy. The Tribunal held that, in view of the retrospective exemption to effluent plants set up with financial assistance from the Governments by the Finance Act, 2012 demand is not sustainable.

Rent-a-cab Service

1.2 Batra Motors & Travels 2013 (30) STR 478 (Tri-Del.)

In this case department confirmed duty demand by treating entire amount in bank as consideration for providing service to individual companies/manufacturing units under contract. The Tribunal held that, Department required to produce evidence to show money receipts relatable to service provided. Entire money in bank statement cannot be held to be consideration for impugned service.

Commercial Training or Coaching Service:

1.3 Indian Institute of Aircraft Engineering vs. UOI 2013 (30) STR 689 (Del.)

The appellant in this case, is an Aircraft Maintenance Engineering Training School approved by the DGCA for providing Aircraft Maintenance Engineering training and conducting examination as per the course approved by DGCA under Aircraft Acts and Rules. They issue a certificate approved by the DGCA to candidates who successfully completed the approved training, curriculum and successfully pass the examinations as per approved course syllabus. The High Court in this case held that, exclusion clause of Section 65(27) has used expression 'recognition by law' and not conferred by law/statute, thus even if certificate/degree/diploma/qualification was not product of statute, but had approval of some kind in law it is exempt from tax. The expression 'recognized by law' is very wide one and it is confirmation of an act done by another person as authorised, formally acknowledging its existence, validity or legality. In view thereof, the CBEC Circular No. 137/132/2010-ST dated 11-5-2011 is contrary to Section 65(27) and Notification No. 33/2011-ST.

2. Interest/Penalties/Others

2.1 CCE, Ahmedabad vs. Amee Castors & Derivatives Ltd. 2013 (30) STR 467 (Tri-Ahmd.)

The Tribunal following the decision in the case of Ramdev Food Products 2010 (19) STR 833 (Tri-

Ahmd.) held that refund of THC, Repo Charges, Documentation Charges, etc. is admissible under Notification No. 41/2007-ST. Refund of fumigation charges is not admissible in the absence of written agreement and in the absence of fulfillment of the conditions stipulated in the said notification.

2.2 Jindal Saw Ltd. (IPU) vs. CCE, Rajkot 2013 (30) STR 490 (Tri-Ahmd.)

In this case appellant discharged service tax liability for purchase of technical evaluation/ assessment of manufacturing process belatedly and contended that no penalty is to be imposed as they were entitled to CENVAT credit. The Tribunal held that appellant was under bona *fide* belief and after relying on decision in Motor World 2012 (27) STR 225 (Kar.) also held that Section 80 is invocable.

2.3 CST, Delhi vs. Consulting Engineering Services (I) P. Ltd. 2013 (30) STR 561 (Tri-Del.)

The Tribunal in this case held that, rate in force at the time of rendering of service is applicable and not the one on date of billing or receipt of payment. Hence, for service rendered prior to 14-5-2006 for which payment was received on or after that date, rate of service tax chargeable was the one in force prior to that date.

2.4 CST vs. Consulting Engineering Services (I) P. Ltd. 2013 (30) STR 586 (Del.)

The High Court in this case held that, receipt of payment for services cannot change date of taxable event. When services were provided and bills were raised prior to 14-5-2003, receipt of payment thereafter was immaterial and rate of tax prior to that date was applicable.

2.5 Suchak Marketing Pvt. Ltd. vs. CST, Kolkata 2013 (30) STR 593 (Tri-Kol.)

In this case department sought to levy late fee for belated filing of 'Nil' ST-3 returns. The Tribunal observed that as per Rule 7C of STR, 1994, discretion is available to assessing authority to waive late fee in event of filing 'Nil' returns and CBEC Circular No. 97/08/2007-ST dated 23-8-2007 clarified that, where services not rendered filing of returns not required. In view of above it is held that, order imposing late fee set aside.

2.6 Zydus Tech Ltd. vs. CST, Ahmedabad 2013 (30) STR 616 (Tri-Ahmd.)

In this case, the department denied refund of service tax paid on Scientific or Technical Consultancy Service and Technical Testing and Analysis Services as the same were not used for authorised operations of the appellant in SEZ unit. The Tribunal held that Development Commissioner of SEZ indicated these services for authorised operations of appellant and such services are must for pharmaceutical industry before marketing and/or exporting the final products. Therefore, these services provided to a SEZ are deemed as export and assessee is entitled for exemption from payment of tax or refund of service tax paid if any.

3. CENVAT Credit

3.1 Mangalore Refinery & Petrochemicals vs. CCE, Mangalore 2013 (30) STR 475 (Tri-Bang.)

In this case, the Mangalore unit of the appellant availed credit for Banking and other Financial Services received under cover of invoices issued by service provider to company's Mumbai office not registered as Input Service Distributor. The Tribunal held that Mumbai office is not registered as ISD hence not allowed to distribute the credit to Mangalore unit. The special provisions would prevail over general provisions and general argument that CENVAT credit cannot be denied for defects in document cannot override specific ISD provisions under the law.

3.2 United Phosphorus Ltd. vs. CCE, Surat-II 2013 (30) STR 509 (Tri-Ahmd.)

In this case the Head Office of the appellant availed credit on photocopies of debit notes

which did not contain name and address of factory to whom services were provided. Head office subsequently produced original debit notes of service provider mentioning Registration No., rate of Service tax and also to whom provided. The Tribunal held that, there is no dispute that services were rendered at HO and HO being registered ISD was eligible to distribute credit to any of their units/factory. Further, it was more so as HO was not issued any SCN for wrong availment of CENVAT credit.

3.3 National Engineering Industries Ltd. vs. CCE, Jaipur 2013 (30) STR 511 (Tri-Del.)

The Tribunal in this case allowed CENVAT credit of certain services availed at registered office at Kolkata and corporate office at Delhi as the same are being maintained for the purpose of business relating to goods being manufactured by the assessee. Further it is held that, there is no stipulation that the input service must be provided or received in the factory of manufacturer.

3.4 Seven Star Steels Ltd. vs. CCE, C&ST, BBSR-II 2013 (30) STR 532 (Tri-Kolkata)

The department in this case sought to reverse CENVAT credit on GTA service as the input transported under the said service has been removed as such. The Tribunal held that Rule 3(5) of CCR, 2004 provided for reversal of credit on inputs and capital goods and inapplicable to input services.

3.5 CCE, Vapi vs. Hindalco Ind. Ltd. 2013 (30) STR 535 (Tri-Ahmd.)

The Tribunal in this case allowed CENVAT credit of service tax paid to commission agent as the same is related to business activity and the Commission agent helps in increasing the sale and renders service in relation to business activity.

3.6 Agriculture Products Market Committee vs. CCE, Vadodara-II 2013 (30) STR 558 (Tri-Ahmd.)

The Tribunal in this case allowed CENVAT credit of service tax paid on Management, Maintenance or Repair service, Advertising Agency service, General and Life Insurance service, Telecommunication service etc., as the said services are used for renting out godowns and are in relation to business activity.

3.7 Semco Electric Pvt. Ltd. vs. CCE, Pune-I 2013 (30) STR 572 (Tri-Mumbai)

The Tribunal in this case allowed CENVAT credit of service tax paid on following services:

- Maintenance and repair service of office equipments installed in factory as the same is used in or in relation to manufacture and export to final products.
- Technical testing and analysis service to check quality parameters of exported goods as without which export of goods cannot take place.
- Management consultancy service for foreign exchange risk management and amalgamation and merger of units of assessee as the said service relates to business activity.
- GTA service used for import of inputs and capital goods as without bringing such goods into factory, manufacture cannot take place.
- Mobile phone/telephones installed at residence of employees to the extent service tax borne by the appellant.
- Catering service has nexus with manufacture of final products.
- C&F agents services used for export of goods, though exempt from service tax, if paid credit is admissible.

3.8 NTF (India) Pvt. Ltd. vs. CCE, Delhi-III 2013 (30) STR 575 (Tri-Del.)

The Tribunal in this case allowed CENVAT credit of service tax paid on housekeeping in factory premises as keeping factory premises neat and clean is a statutory requirement of

Section 11 of Factories Act, 1948 and without its compliance manufacturing operations is not possible. Further, CENVAT credit is also allowed on construction of office rooms in factory premises as it relates to setting up, modernisation, renovation or repair of factory premises and hence specifically covered under definition of input service.

3.9 Golden Tobacco Ltd. vs. CCE, Mumbai-I 2013 (30) STR 594 (Tri-Mumbai)

The Tribunal in this case held that audit, accounting, legal, repair and maintenance and packaging services are having nexus and integrally connected with business of manufacturing, hence input services on which assessee is entitled to take credit of service tax paid.

3.10 CCE, Mumbai-IV vs. GTC Industries Ltd. 2013 (30) STR 673 (Tri-Mumbai)

In this case, the Tribunal observed that under the provisions of Section 46 of the Factories Act, 1948 it is mandatory for the appellant to provide canteen facility for the workers in their factory premises as a measure of welfare of the workers. Further, canteen facility also helps in furtherance of the manufacture hence qualify to be input service.

3.11 Bajaj Hindustan Ltd. vs. CCE, Lucknow 2013 (30) STR 675 (Tri-Mumbai)

The Tribunal in this case held that service tax paid by commission agent in respect of sale of sugar manufactured by the appellant is input service and therefore CENVAT credit admissible.

3.12 CCE, Meerut-II vs. Jindal Pipes Ltd. 2013 (30) STR 686 (Tri-Del.)

The Tribunal in this case held that dismantling of existing structure for erection of new structure is "renovation" which is covered in inclusive part of definition of Input Service.

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Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case No. 1
[2013] 177 Comp Cas 527 (SC) – In the Supreme Court of India

GHCL Employees Stock Option Trust vs. (1) India Infoline Ltd., (2) Nilesh Shivaji Vikamsey, (3) Venkataraman Rajamani, (4) Nimesh Ramesh Mehta, (5) Arun Kumar Purwar, Nirmal, (6) Bhanwarlal Jain, (7) Kranti Sinha.

The Indian Penal Code does not contain any provision for attaching vicarious liability on the part of the managing director or directors when accused is a company and it is obligatory on the part of the complainant to make requisite allegations which would attract the provisions constitutes vicarious liability.

Brief facts

The petitioner has filed this petition against the order of the Delhi High Court under section 482 of the Indian Penal Code ("IPC"). The seven petitions were filed in the high Court against the learned Metropolitan Magistrate order to seven respondents to face trials under IPC. High Court has held that issuance of summons as against the company under section 415 is not sustained and against managing director and others are liable to be set aside.

GHCL Employees Stock Option Trust ("Petitioner") has filed a criminal complaint under section 34/120B/406/409/420/477A of the IPC against India Infoline Ltd. ("Respondent Company") and its Managing Director and other employees ("respondents").

As claimed by petitioner, it has opened a demat account with respondent company and were placing orders from time to time for purchase of shares and making payments thereof. Petitioner claims that as per respondent, it had an outstanding amount of ` 10.48 crores. Further, it has lien on 20,46,195 shares purchased by the petitioner on that account. Based on statement of accounts, petitioner had paid ` 10.48 crores to the respondent company and cleared all its dues. Later on it was found that actual amount due was only ` 10,22,77,522/- and that respondent company has received excess amount of ` 25,22,477.53 under false claim. Petitioner also contended that upon receiving excess amount, respondent company should have transferred the shares kept in pool account to its demat account and also should have refunded the excess money received by it. However, respondent company has asked the petitioner to make payment on account of other five companies and if not paid, they will sell the shares and will clear the dues of above five companies.

As per petitioner, even after continuous follow up and meetings, respondent company failed to refund the excess amount and also sold some shares and misappropriated the money.

As per the respondent company, one of the trustees of the petitioner had written a letter referring to some debit balance in one of the accounts and clearing the same by selling the shares. The said letter also mentioned about the clubbing of account with promoter group company viz GHCL. However, petitioner claimed that the trustee has not written any such letter and that Trust does not have authority to allow its funds to be used towards clearance of others liabilities.

Based on the above *prima facie* facts, metropolitan magistrate issued summons against the respondent company and other respondents to face trials. The respondents then filed petition before the Delhi High Court challenging the order.

It was argued that the High Court has gravely erred in law in taking into consideration the probable defence of accused. It was alleged that the complaint against the managing directors were not on account of any vicarious liability but on the specific allegations. It was submitted that the High Court has exceeded its jurisdiction under section 482 of IPC by looking at the merits of the case. The reliance was placed on the decision of this court in *Madhavrao Jiwajirao Scindia vs. Sambhajirao Chandrojirao Angre [1988] 1 SCC 692* in which Supreme Court has made an observation that the test to be applied is whether the uncontroverted allegations as made *prima facie* establish the offence. The judgment in *S.K.Alagh vs. State of U.P. [2008] 5 SCC 662* was also relied upon.

From respondents, it was also submitted that there cannot be vicarious liability and specific allegation and compliant against individual must be made. It was also contended that it is a civil matter and it is also under arbitration.

Judgment and reasoning

The court has dismissed the appeal and upheld that the High Court has correctly noted that issuance of summons against respondents is illegal and amounts to abuse of the process of law. The Court has considered the averments made in the complaints to find out as to whether the same constitutes offences under various sections of IPC. Court has also observed that they could not find any paragraphs in the averments as to making any specific allegations against the respondents. Court has also observed that the summoning of accused in a criminal case is a serious matter. Court has also relied on judgment in Madhavrao Scindia case re. The judgment in *Punjab National Bank vs. Surendra Prasad Sinha AIR 1992 SC 1815* was also referred where in it was observed that vindication of majesty of justice and maintenance of law and order in the society are the prime objects of criminal justice but it would not be the means to wreck personal vengeance. The judgment in the case of *Maksud Saiyed vs. State of Gujarat [2008] 5 SCC 668* also referred wherein Supreme Court has observed that the IPC does not contain any provisions for attaching vicarious liability on the part of the managing directors or the directors of the company when accused is the company. The above point was also observed in *Thermax Ltd. vs. K.M. Johny [2011] 11 Scale 128.*

Case No. 2

[2013] 177 Comp Cas 523 (SC) – In the Supreme Court of India – Escorts Ltd. vs. Universal Tractor Holding LLC

AND

[2013] 177 Comp Cas 500 (Delhi) – In the Delhi High Court – Universal Tractor Holding LLC vs. Escorts Ltd.

The requirement of "recognition " award under Federal Arbitration Act under U.S. Law is not required due to change in law as per New York convention under which the requirement of double exequatur has been dispensed with for the enforcement of a foreign award.

Brief Case

This special leave petition was filed before the bench to challenge the judgment and order

of single judge of the Delhi High Court on enforcement of a foreign arbitration award.

Universal Tractor Holding LLC ("UTH") has entered into a Membership Interest Purchase Agreement ("Agreement") with Escorts Agri Machinery Inc. ("EAMI") to sell its 49% interest in Beaver Creek Holdings LLC ("BCH"). Both EAMI and BCH are Delaware based corporations. The payment for above sale was to be made in four installments to UTH. EAMI is holding 51% of BCH and JD Escorts Ltd. is the successor-in- interest.

As per UTH, EAMI has paid first two installments and in return it has transferred the proportionate interest in BCH to it. However, EAMI has defaulted in making payment for last two installments and later on paid part amount towards third installment.

UTH has then filed a suit against EAMI before the Wake County Superior Court ("WCSC") in the State of North Carolina. Subsequently, both the parties have agreed for arbitration and accordingly WCSC with the consent of both the parties has passed an order to that effect. However, order has also mentioned that the court shall retain jurisdiction for further proceedings as may be necessary upon completion of arbitration. According to the said order, the arbitration was submitted to the arbitral tribunal ("AT") of the American Arbitration Association ("AAA").

Subsequently EAMI, a wholly owned subsidiary of Escorts Limited ("ET") was merged with ET and in the scheme there was a disclosure as to above pending litigation and arbitration proceedings. Based on the above knowledge of merger of EAMI and ET, UTH has filed application before AT for replacing ET in place of EAMI for arbitration proceedings.

Subsequently, ET has filed a suit in Faridabad Court for declaring that the Agreement entered into by EAMI and UTH is not enforceable and binding on it and so all court proceedings and arbitration process as filed in WCSC and AT is also not valid and binding upon it. ET has also mentioned that UTH cannot claim any loss from ET on account of breach of Agreement. in response to above, UTH has also filed a suit under section 8 of the Arbitration and Conciliation Act, 1996 ("Act") seeking dismissal of suit of ET and the same was pending on account of outcome of arbitration proceedings.

Upon merger of EAMI and ET, the council for EAMI also wrote a letter to AA that he was representing EAMI and not ET and that due to merger, he is no more representing EAMI. There were several mails exchanged between AA and ET as to jurisdiction of arbitration, that ET is not party and other facts. Also, mails from AA to ET about representing in arbitration proceedings were also not attended on one or other ground.

AT has passed an order in favour of UTH, who has filed the present petition for its enforcement.

ET contended that it was not privy to the agreement and therefore no such agreement between it and UTH. Due to which, it can never be a party to arbitration proceedings. ET has placed a reliance on judgments in the case of *Indowind Energy Ltd. vs. Wescare (I) Ltd. [2010] 5 SCC 306; [2011] 164 Comp Cas 261 (SC)* and *S.N Prasad. Hitek Industries (Bihar) Ltd. vs. Monnet Finance Ltd. [2011] 1 SCC 320*. The reference was also made of section 252 (a) of the Delware General Corporation Law where such proceedings not enforceable due to merger which is also mentioned a clause 12.1 of the scheme. ET also submitted that value of BCH is worthless as Farmtrac, another Delware based corporation was under liquidation and its only assets being BCH is subject to creditors claim. ET also claimed that present petition filed under Order 21 of the CPC is not maintainable as same has to be filed under section 48 of the Act for enforcement of foreign award. ET also contended as to arbitration procedure and that it was never given enough time for participating in arbitration proceedings, etc.

UTH has also provided its submission. As per UTH, after the Supreme Court judgment in *Fuerst Day Lawson Ltd. vs. Jindal Exports Ltd. [2001] 6 SCC 356.* In the said judgment, it was mentioned that there is no need for filing a separate petition for enforcement and execution of foreign award. It also submitted as to merger scheme, EAMI submission to arbitration proceedings before WCSC and that same is enforceable against ET. It also referred to the clause 12.1 of the scheme which has also mentioned about arbitration proceedings and that litigation has to be decided as per the Laws of Delaware.

It was also argued by ET that whether award was required to be "recognised" in terms of the Federal Arbitration Act ("FAA") before it could be enforced. However as per UTH, as per the New York convention, the requirement of double exequatur has now dispensed with.

Two questions before the court. First is whether award can be enforced under sections 48 and 49 before same is recognised under FAA. Second question was award can be refused under any ground mentioned in section 48 of the Act however, Delhi court has upheld the UTH petition and rejected the ET's claim.

From ET, it was again referred to section 9 of the FAA regarding the procedure for the "recognition" of award under FAA. It also pointed out that as required under section 48 (1) (e) of the Arbitration and Conciliation Act, 1996, whether consent order is binding or not. Thus, unless award is confirmed as per FAA, same is not binding upon. The judgment in the case of *Oil and Natural Gas Commission vs. Western Company of North America [1987] 1 SCC 496,* was referred , where it was decided that recognition and enforcement of the award will be refused if the same does not become binding on the parties.

From UTH side, FAA section 202 was referred as to foreign award falling under the Convention. The reference of New York convention also made under which requirement of this double exequatur has been removed. The UK judgment in *Rosseel N.V. vs. Oriental Commercial and Shipping Co. (U.K) Ltd* was also referred.

Judgment and reasoning

Court has upheld the decision of single judge of Delhi High Court. Court has observed that as per U.S. Law, a notice of three months is required to be given in case a party does not want the award to be enforced. In current case, the consent order clearly recorded that arbitration award shall be final and binding on the parties. On recognition of award under FAA, court has observed that due to change in law, same is not required.

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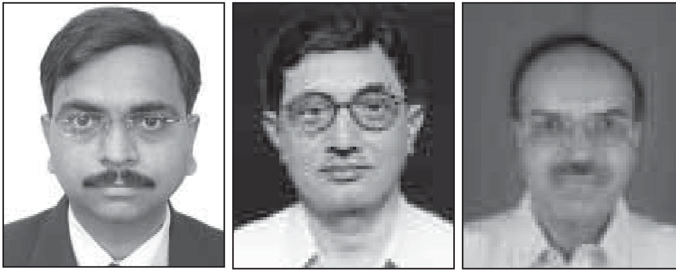

CA. Mayur Nayak, CA. Natwar Thakrar &
CA. Pankaj Bhuta

OTHER LAWS
FEMA Update

In this article, we have discussed recent changes in FEMA through RBI circulars and DIPP Press Notes/Clarifications:

A. RBI CIRCULARS

1. Import of Gold by Nominated Banks/Agencies

Earlier, it was decided to restrict the import of gold on consignment basis by banks, only to meet the genuine needs of the exporters of gold jewellery. It has now been decided to extend the provisions of this circular to all nominated agencies/ premier / star trading houses who have been permitted by Government of India to import gold. Accordingly, any import of gold on consignment basis by both nominated agencies and banks shall now be permissible only to meet the needs of exporters of gold jewellery.

It has further been decided that all Letters of Credit (LC) to be opened by Nominated Banks / Agencies for import of gold under all categories will be only on 100% cash margin basis also all imports of gold will necessarily have to be on Documents against Payment (DP) basis. Accordingly, gold imports on Documents against Acceptance (DA) basis will not be permitted. These restrictions will however not apply to import of gold to meet the needs of exporters of gold jewellery.

[A.P. (DIR Series) Circular No. 107 dated 4th June, 2013]

(In a bid to restrict the glittering gold imports, RBI extended restrictions on gold imports from banks to all other nominated agencies/star trading houses. At the same time, nominated banks and other agencies can import gold only on 100 per cent cash basis unlike using letter of credit (LC). The move appears to be to reduce** the current account deficit and arrest the further **fall of rupee.)

2. Export of Goods and Services – Realisation and Repatriation period for units in Special Economic Zones (SEZ)

Time limit for realisation and repatriation of export proceeds, for the exports made by units in Special Economic Zones (SEZs) is now specified. It has been decided that the units located in SEZs shall realise and repatriate, full value of goods/ software/services, to India within a period of twelve months from the date of export. Any extension of time beyond twelve months may be granted by Reserve Bank of India, on case-to-case basis.

[A.P. (DIR Series) Circular No.108 dated 11th June, 2013.]

(Due to sudden fall of the rupee and in order to discourage exporters in delaying realisation of foreign exchange, RBI has tightened norms for SEZ. The period for realisation of export earnings for non-SEZ units also stands reduced from twelve months to nine months effective from 20th May 2013)

3. Processing and Settlement of Export related receipts facilitated by Online Payment Gateways – Enhancement of the value of transaction

Banks are permitted to offer the facility to repatriate export related remittances by entering into standing arrangements with Online Payment Gateway Service Providers (OPGSPs) for export of goods and services for value not exceeding USD 3000 per transaction, subject to the conditions stipulated therein. It has now been decided to increase the value per transaction from USD 3000 to USD 10,000 for export related remittances received through OPGSPS.

[A.P. (DIR Series) Circular No. 109 dated 11th June, 2013]

(This is a welcome step taken by RBI, whereby it will motivate small exporters in the country.)

4. Foreign Direct Investment – Reporting of issue / transfer of Shares to/by a FVCI

It has been clarified that wherever a SEBI registered FVCI acquires shares of an Indian company under FDI Scheme such investments have to be reported in form FC-GPR/FC-TRS only, as applicable. Where the investment is under Schedule 6 of the Notification No. 20 FC-GPR/FC-TRS reporting is not required. Such transactions would be reported by the custodian bank in the monthly reporting format as prescribed by RBI from time to time.

[A.P. (DIR Series) Circular No. 110 dated 12th June, 2013]

(RBI has taken this step to avoid double reporting of the same transaction)

5. Foreign investment in India by SEBI registered long term investors in Government dated Securities

At present, the limit for investments by FIIs, QFIs and long term investors in Government securities and for corporate debt is US$ 25 billion and USD 51 billion respectively. It has now been decided to enhance the limit for foreign investment in Government dated securities with USD 5 billion to USD 30 billion. The enhanced limit of USD 5 billion will be available only for investments in Government dated securities by long term investors registered with SEBI – Sovereign Wealth Funds (SWFs), Multilateral Agencies, Pension/ Insurance/ Endowment Funds, Foreign Central Banks.

[A.P. (DIR Series) Circular No. 111 dated 12th June, 2013]

(SEBI in concurrence with RBI in order to encourage sovereign wealth funds to invest in India has raised the limit.)

6. External Commercial Borrowings (ECB) for the low cost affordable housing projects

The following changes have taken place in the policy regarding ECB for low cost affordable housing projects:

i. Developers/builders should have a minimum of three (3) year's experience in undertaking residential projects as against five (5) years prescribed earlier and should have good track record in terms of quality and delivery.

ii. The condition of minimum paid-up capital of not less than INR 50 crore, as per the latest audited balance sheet, for Housing Finance Companies (HFCs) stands withdrawn.

iii. The aggregate limit for ECB under the low cost affordable housing scheme is extended for the financial years 2013-14 and 2014-15 with a ceiling of USD 1 billion in each of the two years, subject to review thereafter.

iv. The ECB availed of by developers and builders shall be swapped into Rupees for the entire maturity on fully hedged basis.

Also, the Housing Finance Companies (HFCs) while making the applications shall comply with the following:

a) Submit a certificate from NHB, the nodal agency, that the availment of ECB is for financing prospective owners of individual units for the low cost affordable housing;

b) Ensure that cost of such individual units does not exceed ` 30 lakh and loan amount does not exceed ` 25 lakh;

c) Ensure that the units financed are having maximum carpet area of 60 square metres; and

d) Ensure that the interest rate spread charged by the HFCs to the ultimate buyer is reasonable.

[A.P. (DIR Series) Circular No. 113 dated 24th June, 2013]

(This is a welcome move by the RBI which will provide boost to low cost housing sector through cheaper financing. The RBI eased fund raising norms through external commercial borrowing (ECB) route for the low cost affordable housing *projects. Both housing finance companies (HFCs) and developers are the direct beneficiaries while* ***home buyers too will enjoy their share in terms of concessional interest rates and availability of low cost homes.)***

7. External Commercial Borrowings (ECB) Policy for 3G spectrum allocation

The payment for spectrum allocation can initially be met out of the Rupee resources by the successful bidders that is to be refinanced with a long term ECB, under the approval route. However, this is subject to the condition that ECB should be raised within 12 months from the date of payment of the final installment to the Government.

It has now been decided that the ECB window for financing 3G spectrum rupee loans, that are still outstanding in telecom operator's books of account, will be open up to March 31, 2014.

[A.P. (DIR Series) Circular No. 114 dated 25th June, 2013]

8. Buyback / prepayment of Foreign Currency Convertible Bonds (FCCBs)

RBI has decided to extend the existing scheme of Buyback / Prepayment of FCCBs under the approval route from March 31, 2013, till December 31, 2013 after which the scheme will lapse.

[A.P. (DIR Series) Circular No. 115 dated 25th June, 2013]

(Considering the developments in the global *financial markets, RBI has taken this step.)*

9. External Commercial Borrowings (ECB) for Civil Aviation Sector

ECB for working capital for civil aviation sector should be raised within 12 months from the date of issue of the circular. It has been decided that the scheme of availing of ECB for working capital for civil aviation sector will now continue till December 31, 2013.

[A.P. (DIR Series) Circular No. 116 dated 25th June, 2013]

(RBI has extended the overseas borrowing rules in the aviation sector to allow companies access to cheaper funds.)

10. External Commercial Borrowings (ECB) in Renminbi (RMB)

It was earlier decided that Indian companies in the infrastructure sector are allowed to avail of

ECB in Renminbi (RMB) under approval route subject to an annual cap of USD one billion. From the date of this circular this scheme has been discontinued.

[A.P. (DIR Series) Circular No. 117 dated 25th June, 2013]

11. Export of Goods and services – project exports

Time limits for the exporter undertaking Project Exports and Service contracts abroad for submitting from DPX1, PEX-1 and TCS-1 to the Approving Authority (AA) i.e. AD Bank / Exim Bank / Working Group, is increased to 30 days of entering into contract for grant of post-award approval from previous limit of 15 days.

[A.P. (DIR Series) Circular No. 118 dated 26th June, 2013]

12. External commercial borrowing policy – Import of Services, Technical know-how and Licence fees

As per the extant guidelines, eligible borrowers can raise ECB for the purpose of import of capital goods. Now it has been decided to include import of services, technical know-how and payment of license fees as part of import of capital goods by the companies for the use in the manufacturing and infrastructure sectors as permissible end uses of ECB under the automatic / approval route as the case may be subject to the following conditions:

(i) there should be a duly signed agreement between the service provider and the borrower company;

(ii) the original invoice raised by the service provider as per the payment schedule in the agreement should be duly certified by the borrower company;

(iii) declaration by the importer that the entire expenditure on import of services will be capitalised;

(iv) declaration by the importer that entire expenditure on import of services forms part of project cost; and

(v) AD category-I bank has to ensure the *bona fides* of the transaction.

[A.P. (DIR Series) Circular No. 119 dated 26th June, 2013]

(Amid declining value of rupee, the Reserve Bank of India (RBI) relaxed external commercial borrowing (ECB) norms and allowed companies to use the overseas debt to pay for import of services, technical know-how and licence fee as part of capital goods imports.)

13. External Commercial Borrowings (ECB) Policy – Structured Obligations

Until now, credit enhancement is permitted to be provided by multilateral / regional financial institutions, Government owned development financial institutions, direct/indirect foreign equity holder(s) under the automatic route for domestic debt raised through issue of capital market instruments, such as, Rupee denominated bonds and debentures, by Indian companies engaged exclusively in the development of infrastructure (as defined under the extant ECB policy) and by Infrastructure Finance Companies (IFCs), which have been classified as such by the Reserve Bank.

It has now been decided that credit enhancement can be provided by eligible non-resident entities to the domestic debt raised through issue of INR bonds/ debentures by all borrowers eligible to raise ECB under the automatic route. It has also been decided to reduce the minimum average maturity of the underlying debt instruments from seven years to three years. Prepayment and call/put options, however, would not be permissible for such capital market instruments up to an average maturity period of 3 years. On invocation of such credit enhancement, if the guarantor meets the liability and if the same is permissible to be repaid in foreign currency to the eligible non-resident entity, the all-in-cost

ceilings, as applicable to the relevant maturity period of the Trade Credit / ECBs as per extant guidelines, would apply to the novated loan.

[A.P. (DIR Series) Circular No. 120 dated 26th June, 2013]

14. Risk Management and Inter-Bank Dealings

Under section C (Guidelines for person's resident outside India) of the comprehensive guidelines on 'over the counter foreign exchange Derivatives and overseas hedging of commodity price and freight risks,' - FIIs have been permitted to hedge the currency risk on the market value of their entire investment in equity and/or debt in India. Banks are also required to verify on a periodical basis that the forward cover outstanding is supported by underlying exposures.

It is further clarified that in case an FII intends to hedge the exposure of one of its sub-account holders, it will be required to produce a clear mandate from the sub-account holder in respect of the latter's intention to enter into the derivative transaction. Further, the AD Category I banks shall have to verify the mandate as well as the eligibility of the contract *vis-a-vis* the market value of the securities held in the concerned sub-account.

[A.P. (DIR Series) Circular No. 121 dated 26th June, 2013]

15. Import of Gold by Nominated Banks /Agencies

As per the extant guidelines and according to Circular No. 107 (as discussed above) wherein it was decided to restrict the import of gold on consignment basis by banks, nominated agencies/ premier / star trading houses who have been permitted by Government of India, to import gold only to meet the genuine needs of the exporters of gold jewellery. Further, it was advised that all Letters of Credit (LC) to be opened by Nominated Banks / Agencies for import of gold under all categories will be only on 100 per cent cash margin basis and imports of gold will necessarily have to be on Documents against Payment (DP) basis. Accordingly, gold imports on Documents against Acceptance (DA) basis will not be permitted.

It is further clarified that, import of gold against suppliers/buyers credit, as also import of gold on unfixed price basis has to necessarily observe the discipline stipulated relating to cash margins and Documents against Payment (DP) basis. AD Category I Banks are required to ensure that credit in any form or name is not enabled for import of any form of gold. Import of gold on loan basis may, however, continue to be allowed since the scheme envisages that the nominated banks/nominated agencies can import gold on loan basis for on-lending only to the exporters of jewellery in sync with the non-applicability of the above restrictions to exporters of gold jewellery.

[A.P. (DIR Series) Circular No. 122 dated 27th June, 2013]

B. DIPP PRESS NOTES/ CLARIFICATIONS

1. Review of the policy on foreign direct investment in the Multi Brand Retail Trading Sector – amendment of paragraph 6.2.16.5(2) of Circular 1 of 2013 – Consolidated FDI Policy

Paragraph 6.2.16.5 (2) of Circular 1 of 2013 [Consolidated FDI Policy] includes list of 10 States/Union territories which had conveyed their agreement for implementation of policy relating to Multi-brand Retail Trading.

This press note notifies one more State (i.e. Himachal Pradesh) to be included in the above list pursuant to the consent given by Government of Himachal Pradesh to implement the policy of Multi-brand Retail Trading in Himachal Pradesh. Consequently, the revised list of States / Union Territories has increased to 11.

[Press Note No.1 (2013 Series) dated 3rd June 2013]

2. Foreign Direct Investment Policy – Definition of 'Group Company'

Vide this Press Note, the Government incorporates the following definition of 'Group Company' in Chapter 2 of FDI Policy as contained in Circular 1 of 2013 effective from 5-4-2013 [Consolidated FDI Policy]:

"Group Company means two or more enterprises which, directly or indirectly, are in a position to:-

i. Exercise twenty-six per cent, or more of voting rights in the other enterprise; or

ii. Appoint more than fifty per cent, of members of board of directors in the other enterprise."

[Press Note No. 2 (2013 Series) dated 3rd June 2013]

(DIPP had in 2010 introduced a regulation in the FDI policy restricting cash-and-carry companies from selling more than 25% goods to 'group companies'. DIPP however had not clarified what a 'group company' meant for this purpose, leading to ambiguity as the definition varies under different laws. Despite an introduction of such regulation in FDI Policy, the government was unable to decide whether Bharti Walmart and Bharti Retail were 'group companies' in the absence of a clear definition. Introduction of definition of group company vide this press note would assist the Government in implementing the policy on Cash and Carry Wholesale Trading in its true spirit.)

3. Clarification on queries of prospective investors/ stakeholders on FDI Policy for Multi-Brand Retail Trading (MBRT):

Sr. No.	Issue	DIPP Clarification/ comment	Our Comments
1]	**30% sourcing from Small and Medium Enterprises**		
(a)	Can the Foreign Investor purchase the 30% of the total procurement of manufactured or processed goods by the SME but distribute them either through the retail operation and/ or cash & carry operations and/ or export for the Foreign Investor's International retail & trading operations?	No. The 30% sourcing will be reckoned only with reference to the front end store. As such a multi-brand retailing entity cannot engage in any other form of distribution.	There were press reports that multi-brand retail MNCs Walmart and Tesco had asked for clarification from DIPP whether the sourced goods could be exported to their group entities abroad which had presence in other countries. This clarification puts a restriction on the same.
(b)	Whether a 'small industry' referred to the actual legal entity of manufactured/ processed products purchased with investment within USD 1 million which shall not include its parent company, subsidiaries, affiliates and/or franchisor? Whether farmer,	The phrase used in the FDI policy is 'small industry' with maximum investment in Plant & Machinery at USD 1 million. The sourcing condition pertains only to manufactured and processed products. Procurement of fresh produce is not covered by this condition.	No clarification has been provided by DIPP yet over whether 'small industry' would include its parent company, subsidiaries, affiliates and/or franchisor. Further, not considering direct procurement from farmers of their produce

	cooperative, agro-business including dairy, poultry and fresh, distributor and reseller of major branded companies will be counted as a SME if its investment is within USD 1 million?		for sale through MBRT front end stores towards compulsory 30% norm would be disadvantageous to MBRT MNCs in hyper market formats (as opposed to specialty MBRT chains) which are the only ones currently anticipating making applications under MBRT policy.
2]	**50% investment in back-end infrastructure**		
(a)	Can the new retail entity to be set up acquire supply chain/back-end assets or stake from an existing company having such assets and will such assets /stake values be counted towards the back-end investment requirement?	No. Entire investment in back-end infrastructure has to be additionality. The entity can invest only in Greenfield assets and it will not be possible to acquire supply/chain/backend assets or stakes from an existing entity.	Infrastructure development may not fall within the domain of expertise by MBRT MNCs and therefore they may be unnecessarily burdened by such stringent requirements.
(b)	Would investment (equity stake less than 100%) in a company engaged in development of back-end infrastructure be considered part of the investment in back-end infrastructure if one can certify its use towards back-end capacity?	No. Such investment in the equity of the existing infrastructure company will not be treated towards the fulfillment of the conditionality of 50% investment in back-end infrastructure.	
(c)	Whether investment in back-end infrastructure for instance for storage, warehouses, agricultural produce infrastructure in non-FDI approved states will be counted towards investment in back-end infrastructure.	FDI in these activities is already allowed throughout the country. As far as MBRT is concerned FDI in non-FDI approved States in back-end infrastructure will be counted provided it is an additionality.	This is a welcome clarification since MBRT MNCs were apprehensive that investments in back-end infrastructure in non-FDI approved states may not be considered under MBRT policy.
(d)	Will the new retail entity include back-end facilities that have the capacity to supply its	As per the conditions for wholesale cash & carry trading, such an entity is not permitted to undertake	With this clarification, DIPP's intent of allowing only captive usage of back-end facilities is brought out.

	own businesses and other businesses? It should be free to supply back-end services (e.g. logistic supply, goods) to related or third party companies, including but not limited to the company's existing wholesale entity and the retail franchisee operated by its partners.	retailing of any form. Therefore, both the businesses have to be kept separate through different entities. As regards supplies by MBRT company to franchisees run by its partners, it is clarified that the policy envisages multi-brand trading in retail. The MBRT entity is not envisaged to undertake wholesale activity i.e. B2B. The front-end stores set up by MBRT entity will have to be 'company owned and company operated' only.	Further, prohibition on franchise model would slow the pace of expansion for foreign investors in India.
(e)	Would a company operating in wholesale trading/ cash & carry trading be considered as a company providing back-end infrastructure in efficiently distributing the goods to the small retailers and professional/ business users?	No. The wholesale trading/ cash & carry trading cannot be considered to be providing back-end infrastructure. FDI in MBRT will require fresh investment in back-end infrastructure.	This clarification seems restrictive since separate infrastructure assets used in other formats of business activity of the foreign investor in India cannot be used for MBRT. (For e.g.: Warehouses used for Wholesale trading activity would not be permitted to be used for MBRT and therefore separate capital investment in warehouses for MBRT activity would have to be made although 50% investment criteria in back-end infrastructure would already have been met.)
(f)	Would the minimum investment of 50% of the total FDI in back-end infrastructure be mandatorily invested in the same state where the retail store is proposed to be set up?	The investment towards back-end infrastructure can be made across all states irrespective of the fact whether FDI in MBRT is allowed in that state or not.	Clause (c) above clarified that investment in back-end could be made in non-FDI approved states too. This clarification further explains that the investment could be spread even within the different FDI approved states.

3]	**Investment in Front-end / back-end infrastructure**		
(a)	If the same foreign investor is an investor in various companies for logistics, services etc., will the back-end investment made by such investor be aggregated?	No. Investments in multiple infrastructure companies would not be counted towards fulfillment of condition of investing 50% in the back end infrastructure.	Government stresses here on creating new back-end infrastructure even though the same foreign investor would have investments in infrastructure companies.
(b)	Can back-end and front-end infrastructure be held by separate entities? Can the back-end entity be 100% owned by a foreign entity since 100% FDI is permitted under the automatic route for a company engaged in back-end infrastructure related?	The back-end entity may be 100% owned by a foreign entity as long as the investor in MBRT has been able to satisfy the condition that 50% of the FDI brought into the country for MBRT has been utilized in back-end infrastructure as an additionality.	
4]	**Small industry certification**		
(a)	Suppliers should have some form of authentication to confirm their status as 'small industry'.	Certificate issued by District Industries Centre would be adequate authentication to confirm status of supplier as 'small industry'.	
5]	**Population Restrictions on operations**		
(a)	For determining whether a city has a population of more than 10 lakh, it should not be limited to the data as per the 2011 census. When a city reaches such population level after 2011, it should be allowed to self-certify that it has achieved the population. Further, the population restriction should recognise that twin cities or co-located cities may be eligible based on their combined population.	Census data is the most authoritative source of population data, which is accepted by all the States. Therefore, no other data source or self-certification can be permissible.	This clarification disregards the legitimate possibility of population increase after 2011 Census and does not provide any answer to deal with it. There is no clarification regarding clubbing the population of twin cities for the purpose of calculating the limit of 10 lakhs. However, it appears that population of twin cities cannot be so clubbed.

6]	**State Discretion**		
(a)	The policy should not give states that have approved FDI in multi-brand retail the ability to change the fundamental rules of the FDI policy including but not limited to the 30% 'small industry' sourcing and minimum investment in back-end infrastructure requirements.	States which have opted for inclusion in the FDI policy have already been notified. Any amendment in the policy falls under the domain of the Central Government. However, State laws/ regulations will apply.	This is a welcome clarification since change at State Government level should not put the existing investors in MBRT to a disadvantage following the principle of Legitimate Expectations.
(b)	In case, the foreign investor approaches a State Government for setting up a retail store, can the state Government put additional conditions to operate in that state?	FDI policy in MBRT is subject to the applicable State/Union Territory laws/ regulations. The State Governments have the prerogative of imposing additional conditions accordingly.	Further, irrespective of a change in State Government, the State Government could still impose additional conditions for compliance with State laws.
(c)	In case, the foreign investor approaches a State Government not included in the list of states supporting FDI in MBRT, would the approval of such new state be valid before they are notified to the DIPP for addition in the list?	If the foreign investor approaches a State Government not included in the list of states supporting FDI in MBRT, consent from the State Government would be sufficient, and a suitable amendment to the policy will be issued by the Central Government.	
7]	**Policy on E-commerce**		
(a)	Allowing online sales will enable the Company to better serve Indian customers through enhanced convenience and assortment as well as improve the site customer experience. This will allow the company to make significant investments in Logistics.	Multi-brand retail trading by way of e-commerce is not permitted.	

8]	**Front end retail franchise stores in non- FDI states**		
(a)	Whether the back-end infrastructure could support front end retail franchise stores in non-FDI states at arm's length price.	Back end infrastructure, so developed, can be used across the states by any entity. Franchisee model is not permissible as per extant FDI policy on MBRT. The front-end stores set up by MBRT entity will have to be 'company owned and company operated' only.	Under MBRT policy in FDI Circular, there was no regulation dealing with franchise business model. This Clarification now expressly states that franchise model is not permitted under MBRT policy.
9]	**Investment in greenfield or brownfield front-end entities**		
(a)	Can the minimum investment of US$ 100 Million be used to acquire existing retail stores or setting up new retail stores or a combination of both?	50% of the investments brought in, must be invested in back-end infrastructure, and any amount spent in acquiring front end retail stores would not be counted towards back-end infrastructure. The front-end retail stores must also be set up as an additionality and not through acquisition of existing stores.	This seems to be an additional condition put in by way of clarification as there was no indication of such stand in the FDI Policy till now.

DIPP has further stated that it is still considering some issues, including requirement of 50 per cent of investment in 'backend infrastructure' within three years of the first tranche of FDI, sourcing restriction amongst 'group companies' and whether 30 per cent sourcing from small industry can be allowed 'if it outgrows and if so, till what period'?

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BEST OF THE REST

1. Recovery of bank dues – Liability of Guarantor – Plea that Act has no applicability to mortgages prior to promulgation of statute – Not tenable. – Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002, Ss. 13, 14

The challenge in the writ petition was an order passed by the District Magistrate who had allowed an application under Section 14 of the Securitisation & Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002. The Petitioner had challenged the said order, firstly that the Petitioner has taken loan in the year 1999, whereas the Act was enacted in the year 2002, therefore, the loan already availed by the Petitioner does not fall within the scope of the Act; Secondly, the notice under section 13(2) of the Act was issued, wherein the petitioner filed his objections. The reasons rejecting the objections were communicated. The argument was that such reasons should have been communicated within 7 days. Since the reasons have not been communicated within 7 days, the Bank is precluded from continuing with the proceedings under the Act; Thirdly, that the Bank has not proved any mortgage, therefore, in the absence of proof of mortgage, the proceedings cannot be initiated by the Bank under the Act; and Fourthly, that though at one stage notice under section 13 (2) of the Act was issued to the guarantors, but subsequently the Bank has not initiated any proceedings against the guarantor. It is contended that the amount should be recovered from the guarantor, who is none else, but an advocate. On the other hand the Respondents pointed out that the Bank has filed a suit for recovery of ` 6,79,749.31 before the Civil Court. The suit was for the recovery of said amount by sale of mortgaged property. The said suit was decreed in favour of the plaintiff i.e. Bank. The petitioner filed an appeal against the said judgment & decree before the Additional District Judge. The appeal was also dismissed.

The Hon'ble Court observed that the petitioner cannot be permitted to dispute the decree of the Civil Court by way of the writ petition. It was contended that in any case the petitioner had a remedy to invoke the jurisdiction of the Debt Recovery Tribunal against the action of the Bank to proceed against the petitioner under the Act. But having failed to do so, the petitioner cannot be permitted to raise such questions before the Court by way of writ petition. The Respondent contended that the validity of the Act has been upheld by the Hon'ble Supreme Court in *Mardia Chemicals Ltd. & Ors. vs. Union of India & Ors. (2004) 4*

SCC 311 and as explained in *Transcore v. Union of India & Anr. (2008) 1 SCC 125.* Therefore, the argument that the Act has no applicability to the mortgages prior to promulgation of the statute is not tenable.

The High Court further held that the liability of guarantor is dependant upon liability of borrower, but converse is not true. Borrower is principal debtor and guarantor is liable for payment of the loan amount in terms of guarantee jointly or severally with borrower. It is for creditor to choose as to at what stage amount is to be recovered from guarantor. Petitioner as principal borrower cannot be permitted to say that amount should be recovered from guarantor and not from principal borrower. The Petition was dismissed.

M/s Nippo Foods vs. State of Punjab & Ors. AIR 2013 Punjab & Haryana 89

2. Disclosure of information – Information sought for requisite detail with regard to opening of bank account of institution imparting education – Purpose of obtaining such information was to misuse or threaten institution – Such type of litigation required to be discouraged – Refusal to give information, proper : Right to Information Act, 2005, S. 8(j)

An institution named Arya Kanya Gurukul Chhawani-Sheoganj is a registered society. The said institution is imparting education and schools are running with other social activities within Sheoganj (District Sirohi). The petitioner while having observations over the working of the said institution with regard to legality of the institution for safeguarding public interest at large, filed an application before respondent No. 1 seeking requisite detail with regard to opening of bank account of the said institution under section 5 of the Right to Information Act, 2005. The application filed by the petitioner was rejected in view of section 8(j) of the Act of 2005, read with section 13 of the Banking Companies Act, 1970; and, in the rejection order, respondent No. 1 informed the petitioner that under section 8(j) of the Act of 2005 and under Section 13 of the Banking Companies Act, 1970 no information as desired by the Petitioner can be given to third party because it is not in public interest.

The petitioner being aggrieved and dissatisfied by the order preferred an appeal before the appellate authority of the Punjab National Bank at Delhi which was transferred to the appropriate forum having jurisdiction to hear the matter viz., Public Information Appellate Authority. The said Appellate Authority rejected the appeal filed by the petitioner in which again, it was specifically observed that the required information of bank account of Arya Kanya Gurukul Chhawani – Sheoganj cannot be given to third party and upheld the order passed by the respondent No. 1. The petitioner again preferred Second Appeal under section 19 of the Right to Information Act against both the orders before the Public Information Commissioner which was transferred to the Central Information Commission. The said Appellate Authority while upholding the order passed by the First Appellate Authority dismissed the Second Appeal.

In the writ petition, the petitioner challenged the validity of above orders and contended that the rejection of the petitioner's prayer for supplying bank account of the aforesaid institution is totally unwarranted because as per section 7, at the time of disposal of request by the respondent authorities, they are under obligation to consider section 8(j) of the Act of 2005 objectively; but while giving wrong interpretation to the said provision the respondents rejected the prayer of the petitioner for supplying information with regard to bank account of the institution, therefore, all the orders impugned may

be quashed and respondent No. 1 may be directed to supply information with regard to particulars of bank account of the Arya Kanya Gurukul Chhawani-Sheoganj forthwith.

The High Court held that all the authorities observed in their respective order that as per section 8(j) of the Act of 2005, read with section 13 of the Banking Companies Act, 1970, no information can be given to third party. But time and again the petitioner is insisting for supplying the information to him, that too, without disclosing how he is interested in the functioning of the said institution. It is true that Parliament has enacted the Right to Information Act for transparency in administration, so also, affairs of the state so as to strengthen the faith and trust of the people in the governance of the country. Therefore, the Act is a vital weapon in the hands of the citizens. At the same time, however, this may not be lost sight of that no law shall be allowed to be wielded unlawfully so as to put it to abuse or misuse. Every statute acts and operates within its scope and ambit, therefore, the duty rests with the Courts to discourage litigious obduracy. The petition was dismissed with direction to the Petitioner to pay cost of ` 10,000/-.

Hardev Arya vs. Chief Manager (Public Information Officer) & Ors. AIR 2013 Rajasthan 97

3. Validity of adoption – Adoptee not minor – Merely because adoption deed is registered, Court is not precluded from examining whether or not deed is legal – Despite its registration, Revenue Appellate Authority and Board of Revenue cannot be held to have committed any mistake of law in holding that adoption was invalid: Hindu Adoptions and Maintenance Act, 1956, S. 16

The writ petition was filed by the petitioner seeking to challenge order passed by Revenue Appellate Authority and the Board of Revenue both of whom had set aside order of Sub-Divisional Officer who declared petitioner to be adopted son of deceased, Omkar Gurjar and respondent No. 2 on the strength of adoption deed.

Contention of Petitioner was that the Revenue Appellate Authority and the Board of Revenue have erred in law in holding that adoption of petitioner was not valid because he was 35 years of age on the date of registration of adoption-deed. It is contended that there are certain communities where custom of adoption is prevalent even at late age and someone could be taken in adoption at 35 years of age. His alternative submission is that adoption had in fact taken place when petitioner was a child of less than 15 years of age but the deed got registered after death of Omkar, by his widow respondent No. 2. This aspect of the matter has been overlooked by the Revenue Appellate Authority and Board of Revenue. It is also contended that the S.D.O. has rightly held that since the adoption deed was registered, a presumption would arise as to its validity according to section 16 of the Hindu Adoptions and Maintenance Act, 1956.

The Hon'ble Court observed that the Revenue Appellate Authority clearly indicated that the petitioner was not able to show by any iota of evidence that he was less than 15 years of age when he was adopted. The Board of Revenue has also in its judgment held that the petitioner could not prove the fact that he was adopted by deceased Omkar Gurjar during his life time when petitioner was still a minor or less than 15 years of age. The deceased was survived by three daughters and has no son. The mutation of entire disputed land was attested in favour of respondent No. 2 his widow.

Merely because adoption deed is registered, a Court is not precluded from examining

whether or not the deed is legal. In the facts and circumstances of the case when age of petitioner at the time of adoption is shown to be 35 years, despite its registration, the Revenue Appellate Authority and the Board of Revenue cannot be held to have committed any mistake of law in holding that adoption was invalid. Thus, the petition was dismissed.

Madhu vs. Board of Revenue, Ajmer AIR 2013 Rajasthan 99.

4. Public auction – "E-auction" is another form of public auction which is deemed to be included in R. 56. Recovery of Debts Due to Banks and Financial Institutions Act, 1993, S.29 – Income-tax Act, Sch. 2, Sch. 3 – Income Tax (Certificate Proceedings) Rules, 1962, R. 56

An instruction issued by the Government of India, Ministry of Finance directing the Presiding Officers of the Debt Recovery Tribunals to conduct all auctions electronically was subject matter of challenge. The Petitioner has also challenged the orders passed by the Debt Recovery Tribunal in the matter of attachment and sale, but the court restricted to examine the challenge to the conduct of e-auction.

Recovery of Debts Due to Banks and Financial Institutions Act, 1993 confers power under section 29 of the said Act with the Debt Recovery Tribunal to sell the property of the certificate debtors in terms of 2nd and 3rd Schedules to the Income-tax Act, 1961 and also Income Tax (Certified Proceedings) Rules, 1962. Part-II of 2nd Schedule to the Income-tax Act deals with attachment and sale of immovable property. Rule 56 of the Rules contemplates sale by public auction.

The counsel for the petitioner has vehemently argued that e-auction i.e. where the intending bidders give their bids not in person, but through the medium of electronics on computer in a prescribed format, is not a public auction within the meaning of Rule 56 of the Rules. In support of the argument, the counsel for the petitioner relied upon the judgment of Hon'ble Supreme Court in Chairman and *Managing Director, SIPCOT, Madras & Ors. vs. Contromix Pvt. Ltd.* By its *Director (Finance) Seetharaman, Madras & Anr. AIR 1995 SC 1632.* On the other hand, counsel for the respondents have relied upon sections 4 and 10-A of the Information Technology Act, 2000 to contend that the electronic format is a substitute for anything which shall be required to be done in writing or in the type-written or in the printed form.

The High Court held that there is no provision in the statute which confers jurisdiction on the Central Government to issue directions to the Debt Recovery Tribunals. Section 35 of the Act confers powers on the Central Government to publish an order in the Official Gazette not inconsistent with the provisions of the Act, if it appears to be necessary or expedient for removing the difficulty. Even such order could be passed within three years from the date of commencement of the Act. Therefore, the Central Government was not competent to issue any directions to the Debt Recovery Tribunals under the provisions of the statute. In *M/s. Raman and Raman Ltd. vs. The State of Madras & Ors. AIR 1959 SC 694*, the Supreme Court while examining section 43-A of the Motor Vehicles Act, 1939 held that the power with the Government to dispose of cases in a particular way, would be destructive of the entire judicial process envisaged by the Act. The Central Government was not competent to issue any direction in the manner of discharging its functions by the Debt Recovery Tribunals to order public auction in a particular manner only. The circular at best be treated as a suggestion to conduct auctions electronically, which is worth considering by the Debt Recovery Tribunals to conduct

free, fair and transparent auctions. Therefore, the said circular is, in fact, only giving an option to the Debt Recovery Tribunals to conduct the sale through the preferred mode of e-auction. Though the circular was not within the jurisdiction of the Central Government, but keeping in the salutary purpose, which it seeks to achieve, the process of e-auction is a valid option, but such process cannot be adopted in all circumstances and in all situations by the Debt Recovery Tribunals. The Debt Recovery Tribunals are therefore, directed to adopt the process of e-auction in the case of properties, which are being sold in municipal areas, where the computer knowing personnel would be available to participate in the process. It should be treated as a preferred mode of auction. But in respect of properties situated in rural areas, where the exposure to the computers is less and it is discretion of the Debt Recovery Tribunals to order e-auction as it may consider appropriate. Even after adopting e-auction, if the Tribunals find that the response is not adequate or for any other reason, the Tribunals are free to choose such method it may consider appropriate for sale of property of the defaulters. The petition was disposed of.

Dr. Mandeep Sethi vs. Union of India & Ors. AIR 2013 Punjab and Haryana 82

5. Transfer of ownership of motor vehicle – Endorsement in registration certificate – Cancellation of endorsement made in registration certificate recording transfer of ownership in favour of petitioner improper : Motor Vehicles Act, 1988, S. 50

The brief facts are A. K. Palanisamy, uncle of the petitioner, was owning Toyota Innova car, he executed a sale-cum-delivery receipt in respect of the above stated vehicle in favour of the petitioner. He also executed a Will in respect of other properties – movable and immovable. Based on the sale-cum-delivery receipt, the petitioner approached Indian Overseas Bank, Comibatore and submitted a letter, undertaking to clear the dues payable to the bank in respect of the hypothecation agreement entered into on the purchase of the vehicle by A. K. Palanisamy. The Bank received the said letter. The payment was made by the Petitioner and the bank issued a letter acknowledging the payment of liabilities and also a notice of termination of hire-purchase agreement in Form 35. Based on these records, the petitioner, having become the owner, submitted the documents through an agent for transfer of ownership of the vehicle to his name and accordingly, there is a transfer of ownership of the vehicle, as endorsed in the registration certificate. A. K. Sivasamy, who is the brother of the deceased A. K. Palanisamy, gave a complaint to the second respondent stating that the vehicle has been transferred by the petitioner based on forged documents. On receipt of such complaint, the second respondent addresses a letter to the petitioner calling upon him to produce the registration certificate book, on the ground that there is suppression of fact of the death of A. K. Palanisamy, failing which action was sought to be taken as per law. The petitioner, approached the second respondent and made an oral representation stating that the ownership had in fact changed during the lifetime of the said A. K. Palanisamy and there is no suppression of fact as alleged. This was not accepted by the second respondent and he passed an order cancelling the registration granted earlier with a further direction to submit the consent of the legal heirs of the deceased A. K. Palanisamy and seek registration of the vehicle once again. This was challenged by way of writ petition and the Court directed the petitioner to pursue appellate remedy. Accordingly appeal was filed to the first respondent who dismissed the appeal by an order and that was under challenge in the writ petition.

The High Court held that the reasoning given by the second respondent as well as the first respondent does not entitle them to invoke the provisions of Section 50(2) of the Motor Vehicle Act, 1988, as in this case the transfer of ownership of the vehicle took place pursuant to the sale-cum-delivery receipt. The liability under the hypothecation agreement was discharged later on and based on Form 35 issued by the bank, the registration certificate was endorsed with transfer of ownership in favour of the petitioner. A reading of section 50 of the Motor Vehicles Act, 1988 makes it amply clear that ownership of the vehicle precedes the endorsement of transfer in the registration certificate. Once the transfer is effected by a sale-cum-delivery receipt, section 50(1) of the Motor Vehicles Act, 1988 is attracted. The transfer of ownership takes effect on sale and delivery. That is the tenor of section 50(1) of the Motor Vehicles Act, 1988 and there can be no other manner of interpretation. Section 50(2) of the Motor Vehicles Act, 1988 comes into operation only when there is no transfer of ownership of the vehicle on the date when the owner dies and there is a successor, a purchaser or a person who acquired the vehicle by any manner, which mean other than transfer of ownership as contemplated under section 50(1) of the Motor Vehicles Act, 1988. In the present case, the death occurred on 12-1-2011 and the sale-cum-delivery receipt, to wit transfer of ownership, was effected on 3-1-2011. Therefore, it is a case which falls under section 50(1) of the Motor Vehicles Act, 1988 and not under section 50(2) of the Motor Vehicles Act, 1988. Rule 56 of the Central Motor Vehicles Rules, 1989 relied upon by the respondents can be invoked only in a case when the motor vehicle continues to be with the owner who dies and there is a successor, purchaser, or a person who acquires the vehicle by any other means other than under section 50(1) of the Motor Vehicles Act, 1988. It is not the case here. When apparently the sale-cum-delivery receipt has been effected on 3-1-2011, there is no question of ownership being retained by A. K. Palanisamy. On the date when the registration certificate was endorsed with regard to the transfer of ownership of the vehicle, the petitioner is the owner. When the authorities clearly accept that the sale – cum-delivery receipt was effected during the lifetime of A. K. Palanisamy, it is clear case of transfer of ownership in terms of section 50(1)k of the Motor Vehicles Act, 1988. Moreover, even as per the authorities the allegations of suppression and forgery are to be concluded in the criminal proceedings. Hence the sale-cum-delivery receipt has to be taken as valid till it is proved otherwise. As a result, the petitioner is the owner of the vehicle on transfer as on 3-1-2011. The death of the previous owner is of no consequence. It is to be noticed that the transfer of vehicle by issuance of sale-cum-delivery receipt happens in huge volume due to exploding vehicle population. In a given situation, the erstwhile owner may leave the place after sale, or in certain case may die, as in the present case, and the transferee may not even know the whereabouts of the transferor has to be present at the time of recording of transfer of ownership in a sale that has happened earlier. Hence, only when the factum of death is notice in a case falling under section 50(2) of the Motor Vehicles Act, 1988, the need to follow the said procedure is required. Sections 50(1) and 50(2) of the Motor Vehicles Act, 1988 are meant to address two situations and cannot be clubbed. The Court has no manner of doubt to hold that the transfer of ownership in this case has taken place on the date of sale-cum-delivery receipt, which was effected on 3-1-2011, and the date of recording of transfer of ownership in the registration certificate, is only a procedure prescribed under the Motor Vehicles Act, 1988 and cannot be a ground to dispute the factum of transfer of ownership. The Petition was allowed.

S. R. Ramkrishnan vs. Deputy Transport Commissioner, Coimbatore & Anr. AIR 2013 Madras 100

CA. Rajaram Ajgaonkar

ECONOMY AND FINANCE

UNCERTAINTIES IN INDIA

The month of June has been very eventful for the global economies. During the month, the US economy continued its upward march. The economic data was positive on most of the fronts and the sentiment kept on improving. All the evidence suggested that the US economy was getting back on track. Curiously that gave birth to uncertainty. Suddenly, there was a talk that the quantitative easing practiced by the US Fed for the last few years will fade soon and that posed a new risk.

Investors realised that the end of the quantitative easing will also end the regime of easy money and that can slow down the economic growth stimulated by such money. Share prices suddenly dropped and even bond prices came under pressure. Demand for gold and crude oil slipped resulting in lowering the prices of these commodities. There was an emergence of a cloud of uncertainty. Over the last few years, the excess liquidity in the US market had found lucrative turfs in the emerging markets. Therefore lowering of sentiment did not just remain restricted to the US market but it also percolated into many other economies across the world. The bettering growth in the US economy improved the opportunities therein. This resulted in flow of funds to the US. The US dollar strengthened and many currencies across the world depreciated against it.

A sudden liquidity crisis emerged in the Chinese economy towards the end of June. The Interbank interest rates shot up to an unreasonable level of beyond 13% and the banking system came under pressure. The liquidity in that economy evaporated considerably causing concern and resulting in squeeze of credit and hardening of interest rates. The change of sentiment was extremely abrupt and damaging. China Security Index (CSI Index) dropped more than 15% within the month of June, which was very damaging for the investor sentiment. China, being a major economy on which numbers of economies in the region depend upon for their exports, those other economies also came under pressure. The whole of Asia Pacific felt the heat and stocks lost ground across a wide front. Positive sentiment in the US gave some respite to the worried Asia but it was not sufficient to recoup the losses. The stock markets in the region ended the month of June with fair amount of red.

Japan remained a bright spot in the uncertain Asia. Its economic reforms continued to give positive results. The sudden uncertainty in China opened the door of opportunity to Japan and that gave a positive push to the Japanese economy and stock market. The Japanese stock market, which was retreating from its peak in the month of May, halted its reversal and started regaining its traction. The current developments are positive for the Japanese economy. After a long time, Japan is likely to achieve sustainable growth. Over

the last couple of decades, China stole the show from Japan as low cost supplier to the developed markets. Since China went on a fast track, the Japanese economy stagnated. Now China may be slowing down and that may give a chance to Japan to regain its past glory.

Middle East and some countries in North Africa are faring better. Though the crude oil prices are not rising, the economies in the Middle East are looking up. It is coming out of the prolonged shock of global meltdown and political uncertainty, while the risk lurks in the shadows. The region may continue to perform better, especially if the US economy does well. Each of the economy in the region has its own fundamental and political problems but the overall situation is looking better for the Gulf countries like Iraq, Kuwait and the UAE. The revival has started attracting investments in the region. Except for a few countries, the region is under developed and there is a good scope for improvement.

Things have not changed much in Europe in the last month but sentiment has probably started looking up due to the improved American economy. The US is a major trade partner of the European Union and Europe is also a major beneficiary of the spending of the Americans on tourism and hospitality. Worst seems to have been over for Europe and the efforts of the major countries in the region are showing results. The then looming crisis seems to have been avoided.

After two positive months of April and May the sentiment has suddenly dipped in the Indian economy. Earlier, the economy was holding on sans very encouraging data, simply on the expectation that economy will revive soon. However, suddenly it is realised that Indian trade imbalance has become severe and the scramble for the US dollar has increased. At the same time the improvement in the US economy has made that market attractive for a number of foreign investors resulting in capital outflow from developing countries like India. The US currency has strengthened against most of the currencies in the world. It has gained more strength against the currencies of developing economies like India as compared to the developed countries. There was an exodus of capital of more than 5 billion US$ from India in the month of June and that has considerably weakened the Indian rupee. It tested the psychological barrier level of ` 60 per US$ and continued to remain weak even at that level. The weakening of the Indian rupee over the last few months was abrupt, though not totally unexpected. The rupee has lost 6.75% against the US$ in the month of June and has lost 10.88% against the said currency during the first fiscal quarter of 2013-14. This free fall of rupee, inspite of some intervention from the Reserve Bank of India, has created quite a panic in the Indian economy and specially amongst importers. One of the major culprits of India's trade deficit is the continuous huge import of gold, which is utilised for hoarding and investment and not used for any major economic activity. The Government of India took prompt action and increased the import duty on the import of gold to 8% to deter imports. The reduction of the price of the petroleum products has also helped India. However, the exodus of foreign investment from Indian economy has made considerable damage and the rupee remains weak; causing wide spread panic amongst Government, Industry and Business. Though inflation was coming under control, the falling rupee has held back the Reserve Bank of India from reducing the benchmark Interest rate causing frustration in the Indian Economy. As a result the overall negative sentiment, the stock market lost around 6% during the month of June before bouncing back at the end of the month. It is being said that worst is over for the Indian economy but clear signals of turnaround are still not visible.

The Indian stock markets have dropped considerably but there is a hope that they may start reviving. Many foreign funds are optimistic about India, not because the fundamentals are very great as of now but many other investment destinations in the same class are not attractive enough. With China slowing down and other two BRIC countries namely Brazil and Russia not remaining attractive enough, there can be a

continuity of flow of funds in the Indian stock markets. Therefore it is expected that the Indian stock markets will rise by 10% to 15% during the next one year. Historically it is noticed that when the elections come near, the stock markets do rise. Though the debt market is holding on in India due to high interest rates, it is expected to taper off during the course of the next few years. Asset classes such as gold, other precious metals and precious stones including diamonds are not expected to fair great. Property may fare well only in certain pockets in the country. Therefore equity investment remains a preferred asset class over the next few years for the investors and mainly global investors. Indian markets are not cheap but they are not very expensive either. The Indian equities are under-owned by Indians and specially retail investors due to continuous sluggishness and low returns over the last five years. If political will is mustered to push reforms and avoid populist approach towards economic development, Indian economy can regain its growth momentum. Indian stock markets are likely to be rerated within the next few years and therefore it may be advisable for Indians and specially to retail investors to return back to equity atleast in a small way. Inflation continues to be high and currency remains weak. This poses risk to Indian economy. However, investment sentiment is ruling low and prices have already reacted. There is a possibility of good return from equity investment over a period of next few years. The stock markets are currently range bound and if an investor has invested in equity at the Sensex level of 19,000 or below, it may be worth booking partial profit, if Sensex crosses the level of 20,000. An opportunity to buy cheaper again may emerge. It appears that time is right to increase overall weightage on equity investment and also on Mutual Fund schemes predominantly investing in equity.

It was expected that interest rates will come down in India and they will drag down deposit rates and bond yields. The current weakness of rupee has played a spoilsport and Reserve Bank of India has refrained from rate cuts. If the rupee remains volatile and weak, the interest rate cut will be postponed further. Whenever the rate cut begins, it is expected that the rates will be cut by 0.5% to 0.75% before 31st March 2014. Therefore dropping of interest rates is inevitable though when will it start is a million dollar question. Investors are advised to lock in long term investment plans with high rate of returns as the opportunities may start dwindling in the near future.

Indian rupee has substantially weakened over the last few weeks and that has affected most of the sectors of the Indian economy. Uncertainties are on rise and markets have become volatile. Government has made efforts to control the weakness of rupee but the measures have not yielded adequately. It is possible that rupee may lose further ground for the time being. After a few months, it may rebound and may stabilize between 56 and 58 Rupees per US$. The weakness of rupee has again emphasized the need for high net worth investors to diversify their portfolio to non rupee denominated investments. A resident individual, including a minor can take advantage of the Liberalised Remittance Scheme as per which he can freely remit upto US $ 200,000 per financial year for investment or any other permissible purpose. An investor can invest in equities of foreign companies mainly established in the developed markets such as the US, Japan etc. by remitting money as per this scheme. These economies are currently in revival mode and stock markets therein are expected to have an upside even from the current levels. However such investment should be based on proper study and advice. Transaction costs in such markets are high and investors having inadequate information may get trapped.

The month gone by has been quite challenging for the Indian economy and Indian investors. The uncertainties and risks have increased. However, over a medium term, investors will do well to increase their weightage towards equity without getting unduly worried by the price fluctuations in the stock markets. Bad times do not sustain indefinitely. Better times may be just around the corner.

V. H. Patil, *Advocate*

YOUR QUESTIONS & OUR ANSWERS

Facts & Query

Q.1 The Balance Sheet of a private limited company as on date is as under:

Liabilities	`	Assets	`
Share capital	100,000	Cash and Bank	25,000
Sr. Creditors	20,00,000	Profit and Loss A/c	20,75,000
Total	21,00,000	Total	21,00,000

The company is proposing to go for a voluntary liquidation and has the following queries:

A. Whether the creditors outstanding will on write off/cancellation give rise to tax incidence under sections;

a. 41(1)

b. 115JB

B. If yes, can the amount be recovered from the directors as the company is not in a position to pay off the same

Ans. Under the provisions of S. 41(1) of the I.T. Act, 1961, a write off is to be of a trading liability. As such write off of trading creditors will be covered by S. 41(1). As Sr. creditors are not trading creditors, as such write off Sr. creditors, not being trade creditors does not fall under the provisions of S. 41(1) of the Act.

As such, such write off, does not lead to any tax liability u/s. 41(1) of the Act.

Now under the provisions of S. 115(JB) the concept and the tax position, being the same as under S. 41(1), such write off of secured creditors' liability does not attract, S. 115JB also.

As such in our case such write off does not fall under these two sections. As no tax liability arises under these two sections, the issue raised under Q.2(B) does not arise.

Q.2 A partnership firm having accumulated business losses and unabsorbed depreciation in preceding two years is proposing to convert to a Limited Liability Partnership under the provisions of Section 47(xiiib). Will the brought forward losses and unabsorbed depreciation be available for set off to the LLP?

Ans. Under the definition of a `firm' under I.T. Act cl. 23(i) of S. 2 of I.T. Act, it includes, a limited liability partnership, as defined under LLP Act of 2008, and as such when a partnership firm converts itself into, a LLP it will be the same entity and not a different entity from the firm.

As such when a partnership, converts itself into a LLP, there is no change from one entity to another entity. As such the carried forward depreciation allowance and of the business losses of the firm, will be available of the LLP and it can carry forward, these unabsorbed, depreciation allowance and business losses, to the later years for setting them off against the income of the later years.

Q.3 A, B and C carried on business of trading in steel as a partnership firm with each of them being equal

partners. C desires to retire from the business and the partners propose to pay him his share in the value of the business as under;

Credit his account by 1/3rd, i.e., his share in the fair market value of the business and assets and debit it to the other partners equally.

Thereafter, D is to be introduced into the partnership and he will introduce the amount required to pay off C.

The partners have been advised that there could be capital gains tax in the hands of the outgoing partner as he has assigned his share in the firm to the incoming partner. Is the apprehension correct?

Ans. Now when a partnership firm is partitioned and its assets are distributed among the partners there is no transfer from one person to another person and as such under General Law it is not a transfer.

Now on the facts of the case, the relevant provisions are Ss.45(1) and 45(4), which are as under:

S.45.(1) Any profits or gains arising from the transfer of a capital asset effected in the previous year shall, save as otherwise provided in sections [***] [54, 54B, [***] [[54D, [54E, [54EA, 54EB,] 54F [, 54G and 54H]], be chargeable to income-tax under the head "Capital gains", and shall be deemed to be the income of the previous year in which the transfer took place.

S.45(4). The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a co-operative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and, for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer.

Now under the provisions of S. 45(4), if an asset of the `firm' is allotted to the outgoing partners, there will be liability for capital gain in the hands of the partnership firm, but for that purpose from the market value of the asset allotted to the outgoing asset, minus the actual cost of the asset to the firm, will be capital gain arising out of such transfer.

As in our case the accounts of the outgoing partners are settled as per Balance Sheet value, there will be no taxable gain in the hands of partnership firm and if at all under the capital gain, it will be a capital gain loss in the hands of the firm. In any case it is not taxable in the hands of the outgoing partner, to whom such asset is allotted.

Now, as the incoming partner has not purchased the share of the outgoing partner, no tax liability arises in the hands of incoming partner also.

Q.4 Mr. A had purchased a tourist passenger bus in his own name in April 2010. He utilized it for a partnership firm which was in the field of play production in which he was a partner and in return he was paid car hire charges from the firm. In April 2011 he transferred the vehicle to partnership firm as his capital addition at a value below its WDV as per his books. Mr. A showed this as a loss on transfer of vehicle. Can he set off this loss against the remuneration income received from his partnership firm?

Ans. Mr. A is a partner in the firm, receiving rent for his services to the firm, he is receiving the rent for the services he is rendering as a partner and for that purpose he has purchased these vehicles and as such he had purchased them for use for the purpose of the firm, and it is for the purpose of its business and it is used in the course of his business, he can set-off such loss against the rent he has received from the firm.

Q.5 A new LLP was incorporated and following expenses were incurred:

a. Stamp duty for LLP agreement

b. Documentation charges for drafting of the LLP agreement and other professional fees for formation

c. Fees of ROC

Are the above expenses allowable as a revenue expense to the LLP?

There was a change in constitution of the LLP and documentation fees and professional fees were paid to consultants. Whether these are allowable as deductible expense to the LLP?

Ans. The answer to this question, as to whether such expenditure relating to documentation, relating to the conversion of the firm into a LLP depends on the issue, as to whether such conversion is for the purpose of the business of the firm and, is it in the course of carrying on of its business? If the answer is yes, such expenses relating to such documents are allowable. If not they would be expenditure on capital account and they will not be allowed as business expenses, against the income of the firm or of LLP. Same would be the case, in case of change in the constitution of the newly formed LLP.

On these discussions our answers of the queries raised by the querist are as under:

Q.1A) Whether the creditors outstanding will on write off/cancellation give rise to tax incidence under sections;

c. 41(1)

d. 115JB

Ans. 41(1) No.

115JB No

Q.1B) If yes, can the amount be recovered from the directors as the company is not in a position to pay off the same

Ans. No. As no liability arises in the hands of the firm, this question does not arise.

Q.2 A partnership firm having accumulated business losses and unabsorbed depreciation in preceding two years is proposing to convert to a Limited Liability Partnership under the provisions of Section 47(xiiib). Will the brought forward losses and unabsorbed depreciation be available for set off to the LLP?

Ans. Yes. The LLP will be entitled to carry forward the unabsorbed depreciation allowance and business loss for set off against income of the future years.

Q.3. A, B and C carried on business of trading in steel as a partnership firm with each of them being equal partners. C desires to retire from the business and the partners propose to pay him his share in the value of the business as under;

Credit his account by 1/3rd, i. e,; his share in the fair market value of the business and assets and debit it to the other partners equally.

Thereafter, D is to be introduced into the partnership and he will introduce the amount required to pay off C.

The partners have been advised that there could be capital gains tax in the hands of the outgoing partner as he has assigned his share in the firm to the incoming partner. Is the apprehension correct?

Ans. No. There is no liability for capital gain in the hands of the firm and also in the hands of the outgoing partner, and also in the hands of the incoming partner.

Q.4 Mr. A had purchased a tourist passenger bus in his own name in April 2010. He utilized it for a partnership firm which was in the field of play production in which he was a partner and in return he was paid car hire charges from the firm. In April 2011 he transferred the vehicle to partnership firm as his capital addition at a value below its WDV as per his books. Mr. A showed this as a loss on transfer of vehicle. Can he set off this loss against the remuneration income received from his partnership firm?

Ans. Yes. Mr. A can set off such unabsorbed depreciation allowance and business losses carried forward and set off them against the income of later years.

Q.5 A new LLP was incorporated and following expenses were incurred:

a. Stamp duty for LLP agreement

b. Documentation charges for drafting of the LLP agreement and other professional fees for formation

c. Fees of ROC

Are the above expenses allowable as a revenue expense to the LLP?

There was a change in constitution of the LLP and documentation fees and professional fees were paid to consultants. Whether these are allowable as deductible expense to the LLP?

Ans. These expenses in both the cases will be allowed if such expenses are incurred for the purpose of firm's business and are incurred in the course of its business. If not they will be capital expenses and they are not allowable as business expenses under S. 37(1) of the I.T.Act.

Hitesh R. Shah & Hinesh R. Doshi, *Hon. Jt. Secretaries*

THE CHAMBER NEWS

Through this column, we communicate important events and the happenings that take place at the CTC. The events that have taken place after the previous issue of the The Chamber's Journal from **8th June, 2013 till 8th July, 2013.**

I. Admission of New Members

1) The following are the new members, who were admitted to the Managing Council meeting held on 26th June, 2013 & 4th July, 2013.

26th June, 2013

LIFE MEMBERSHIP

1	PAREKH SANJAY JAYANTILAL	CA	MUMBAI

ORDINARY MEMBERSHIP

1	MR. MAJMUDAR SHAMIT TRIDASH	CA	MUMBAI
2	MRS. PALIWAL KANAK R.	ADVOCATE	NAGPUR
3	MR. JAIN VICKY RAMESHKUMAR	CA	MUMBAI
4	MR. VERMA VIRENDRA KUMAR	CA	NEW DELHI
5	MRS. GUPTA NEETU PAWANKUMAR	CA	HARYANA
6	MR. TANNA RASIK AMRITLAL	CA	MUMBAI
7	MR. CHHADVA BHAVESH SHAMJI	CA	MUMBAI
8	MR. ANUPAM PETKAR	CA	MUMBAI
9	MR. SHAH DARSHAK KISHORE	CA	MUMBAI

STUDENT MEMBERSHIP

1	MR. VIGNESH SETHURAMAN	CA FINAL
2	MR. BHATT TEJ VIJAY	F. Y. BCOM / CPT

4th July, 2013

LIFE MEMBERSHIP

1	MR. NAULAKHA VIDHAN KAMAL	CA	MUMBAI

ORDINARY MEMBERSHIP

1	MR. MITRA BIMAL D.	ITP	MUMBAI
2	MR. GOGRI KETAN JIVRAJ	CA	MUMBAI
3	MR. FERNANDES RYAN ANTHONY	CA	MUMBAI
4	MS. ARYA YOGESH SANDEEP	CA	MUMBAI

II. Past Events

1. BRIEF REPORT ON 86th ANNUAL GENERAL MEETING

At the 86th Annual General Meeting held on Thursday, 4th July, 2013 the following business was transacted:

i) The Annual Report for the year 2012-13 was approved & adopted.

ii) The Accounts for the year ended 31st March, 2013 were adopted.

iii) Shri J. L. Thakkar, Chartered Accountant, was appointed as Auditor for the year 2013-14 and will hold office upto the next AGM.

iv) Results of the elections for the year 2013-14 were declared as follows :

- Shri Yatin Desai was elected as President
- The following thirteen members were elected to the Managing Council
  1. Shri Ajay Singh
  2. Shri Apurva Shah
  3. Shri Ashit Shah
  4. Shri Ashok Sharma
  5. Shri Avinash Lalwani
  6. Shri Haresh Kenia
  7. Shri Hitesh Shah
  8. Shri Hinesh Doshi
  9. Shri Ketan Vajani
  10. Shri Paras Savla
  11. Shri Paresh Shah
  12. Shri Vijay Bhatt
  13. Shri Yatin Vyavaharkar

THE DASTUR ESSAY COMPETITION

The first three winners of the Dastur Essay Competition viz. Ms. Shreya Yogesh Jatia, Mr. Dhavnish Jagdip Shukla, Mr. Saurabh Rajendra Wagle were felicitated by Past President, Shri V. H. Patil, Shri Manoj Shah, (Imm. Past President) and Past President Shri Kishor Vanjara. Other five winners were also felicitated and issued certificates.

THE NEW TEAM FOR 2013-14

i) In the First Managing Council Meeting held on Thursday, 4th July, 2013, the following members were elected as **Office Bearers**

	Name	*Designation*
1.	Shri Paras Savla	Vice-President
2.	Shri Hitesh Shah	Hon. Jt. Secretary
3.	Shri Hinesh Doshi	Hon. Jt. Secretary
4.	Shri Avinash Lalwani	Hon. Treasurer

ii) The following eight members were Co-opted to the Managing Council for the year 2013-2014

1. Shri Jayant Gokhale
2. Shri K. Gopal
3. Shri Keshav Bhujle
4. Shri Kishor Vanjara
5. Shri Mahendra Sanghvi
6. Shri Parimal Parikh
7. Shri Vipul Choksi
8. Shri Vipul Joshi

iii) The following members were requested to be "Special Invitees" for the year 2013-14

1. Shri V. H. Patil
2. Shri Anil Harish
3. Shri Bhavesh Vora
4. Shri Deepak Shah
5. Shri Sujal Shah

iv) EDITOR & EDITORIAL BOARD OF THE CHAMBER'S JOURNAL

Shri V. H. Patil was appointed as Chairman of Editorial Board and Shri K. Gopal was appointed as Editor of "The Chamber's Journal".

Editorial Board Members:

1. Shri Keshav Bhujle
2. Shri Kishor Vanjara
3. Shri Pradip Kapasi
4. Shri S. N. Inamdar
5. Shri Subhash Shetty

v) COMMITTEES

The following Committees were formed and their Chairmen, Co-Chairmen and Vice Chairmen were appointed:

	Committee	***Chairman/Co-Chairman/ Vice-Chairman***
1.	Allied Laws	Shri Ashok Sharma
2.	Corporate Members	Shri Vipul Choksi
3.	Direct Taxes	Shri Ajay Singh – Chairman Shri Ketan Vajani – Vice Chairman
4.	Indirect Taxes	Shri Ashit Shah
5.	International Taxation	Shri Paresh Shah
6.	International Technology	Shri Manoj Shah
7.	Journal	Shri Yatin Vyavaharkar – Chairman Shri Apurva Shah – Vice Chairman
8.	Law & Representative	Shri Vipul Joshi – Chairman Shri Mahendra Sanghvi – Co-Chairman
9.	Membership & EOP	Shri Parimal Parikh
10.	Research & Publication	Shri Jayant Gokhale
11.	Residential Refresher Course & Public Relation	Shri Vijay Bhatt
12.	Study Circle & Study Group	Shri Haresh Kenia

2. ALLIED LAWS COMMITTEE:

The **Allied Laws Study Circle Meeting** was held on ***5th July, 2013*** on the subject "Provisions relating to Tenancies held by Partnership Firms, Companies & LLPs". The meeting was addressed by Shri Divyakant Mehta, Advocate.

3. DIRECT TAXES COMMITTEE:

The workshop on TDS was held on 15th June, 2013. The workshop was addressed by CA Nishit Kapadia, CA Mahendra Sanghvi, Mr. Deepak Tralshawala, Advocate, CA Mayur Nayak. Mr Keshav Bhujle, Advocate, CA Gautam Nayak and CA Mayur Nayak were Brain Trustees for the Brains' Trust session.

4. INTERNATIONAL TAXATION COMMITTEE:

The **7th Residential Refresher Conference on International Taxation – 2013** was held from ***20th June, 2013*** to ***24th June, 2013*** at The Golden Palms Hotel & Spa, Bengaluru. The conference was inaugurated by CA Manoj Shah, President. The conference was held for 4 days and consisted of 7 Technical Sessions, Group Discussion topics and Presentations on latest issues were presented by well-known experts in the field of International Taxation.

5. STUDY CIRCLE & STUDY GROUP COMMITTEE:

- *STUDY CIRCLE MEETINGS:*

The Study Circle Meetings were held as under:

a) On 11th June, 2013 on the subject "Taxation of Builders and Developers", which was addressed by CA Jagdish Punjabi.

b) On 27th June, 2013 on the subject " Issues under Capital Gains – Sections 54, 54F, 54EC & Section 50C, which was chaired by Mr. Vipul Joshi, Advocate and was led by Mr. Mandar Vaidya, Advocate. The meeting was in continuation of earlier meetings held on 31st October, 2012 and 17th January, 2013.

c) The **Lecture meeting** was held jointly with Direct Taxes Committee on ***8th July, 2013***, on the subject ***"E-Filing of Income Tax Returns – Issues & Recent Developments including uploading of Tax Audit & other reports"***. The meeting was addressed by CA Ameet Patel.

- *STUDY CIRLCE MEETING ON INTERNATIONAL TAXATION:*

The Study Circle Meeting on International Taxation was held on 17th June, 2013 on the subject "Taxation of Shipping Company" and was addressed by CA Natwar Thakrar.

- *STUDY GROUP MEETING:*

The Study Group Meeting was held on 28th June, 2013 on the subject "Recent Judgments under Direct Taxes" and was led by Mr. Nitesh Joshi, Advocate.

III. Future Events:

1. ALLIED LAWS COMMITTEE:

The next **Allied Laws Study Circle meeting** will be held on ***12th July, 2013*** on the subject "Tax Auditor's Report on Financial Statements in view of SA 700, SA 705 & SA 706". The meeting will be chaired by CA Jayesh Gandhi and will be addressed by CA Anand J Banka.

2. DIRECT TAXES COMMITTEE:

The next meeting of **"Intensive Study Group on Direct Taxes Laws"** will be held on *11th July, 2013.* The meeting will be addressed by CA Kiran Kapadia on the subject "Recent Important Decisions under Direct Taxes".

3. JOURNAL COMMITTEE:

The Journal Committee is planning to bring special story **"Service Tax Voluntary Compliance Encourage Scheme – 2013"** in the forthcoming issue for the month of *August, 2013.*

4. STUDY CIRCLE & STUDY GROUP COMMITTEE:

The **Study Group Meeting** will be held on **17th July, 2013** on the subject "Recent Judgments under Income Tax". The meeting will be addressed by CA Pradip Kapasi.

IV. Publications for sale:

A. **International Taxation – A Compendium**

Four hardbound volumes set containing approx. 4000 pages.

B. **Study Material – 7th Residential Conference on International Taxation, 2013 held from 20th June, 2013 to 23rd June, 2013 at Bengaluru.**

V. Renewal of Membership 2013-2014:

The renewal fees for Annual Membership, Subscription of IT Review, Study Group and Study Circles meeting and other subscription for the financial year 2013-14 falls due for payment on 1st April, 2013.

The details of the Fees are as under:

		FEES	SERVICE TAX	TOTAL
1.	Membership Renewal Fees (for 1 year)	` 1,300/-	` 161/-	` 1,461/-
2.	The Chamber's Journal Subscription (Life Members)	` 550/-	–	` 550/-
3.	The Chamber's Journal Subscription (Non Members)	` 1,000/-	–	–
4.	Associate Membership	` 2,000/-	` 247	` 2,247
5.	Student Membership Fees	` 250/-	` 31/-	` 281/-
6.	Study Group (Direct Taxes)	` 1,250/-	` 155/-	` 1,405/-
7.	Study Circle (Indirect Taxes)	` 700/-	` 87/-	` 787/-
8.	Study Circle (International Tax)	` 1,000/-	` 124/-	` 1,124/-
9.	Study Circle (Allied Laws)	` 700/-	` 87/-	` 787/-
10.	Study Circle (Direct Taxes)	` 700/-	` 87/-	` 787/-
11.	Study Circles (Direct Tax & Allied Laws Combined)	` 1,000/-	` 124/-	` 1,124/-
12.	Self Awareness Series	` 350/-	` 43/-	` 393/-
13	Intensive Study Group on Direct Tax	` 1,000/-	` 124/-	` 1,124/-

(*) The amount of Service Tax and Cess may change if there is change in the rate.

(For Enrollment and further details of all the future events, please refer to the July, 2013 issue of CITC News or visit the website www.ctconline.org)

INTERNATIONAL TAXATION COMMITTEE

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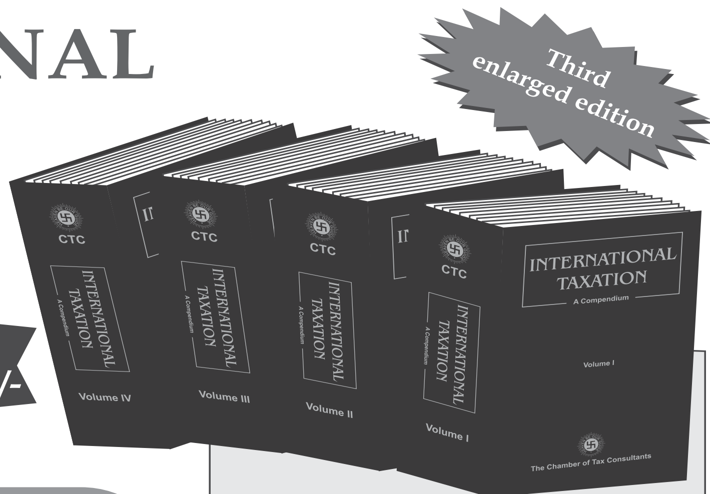

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DIRECT TAXES COMMITTEE – 2012-13

Workshop on Tax Deduction at Source held on 15th June, 2013 at M. C. Ghai Hall, Fort

Shri Ajay Singh, Chairman welcoming the delegates. Seen from (L to R) : CA Manoj Shah, President, CA Nishit Kapadia, Faculty, CA Dinesh Poddar, Convenor

CA Mahendra Sanghvi, Past President addressing the delegates. Seen from (L to R): S/Shri Ajay Singh, Chairman, CA Manoj Shah, President, CA Dinesh Poddar, Convenor

Faculties

CA Nishit Kapadia

Mr. Deepak Tralshawala, Advocate

CA Mayur Nayak

Section of Delegates

Shri Keshav Bhujle, Advocate replying the queries at Brain Trust Session. Seen from (L to R) : CA Ketan Vajani, Vice Chairman, CA Gautam Nayak, Trustee, CA Mayur Nayak, Trustee, CA Hitesh Shah, Hon. Jt. Secretary

1st Intensive Study Group (Direct Taxes) meeting held on 5th June, 2013 on the subject "Recent Important Decisions under Direct Taxes"

CA Ashok Sharma addressing the members. Seen from (L to R) : Shri Ajay Singh, Chairman, CA Ketan Vajani, Vice Chairman

INTERNATIONAL TAXATION COMMITTEE – 2012-13

7th Residential Conference on International Taxation – 2013 held on 20th to 23rd June, 2013 at The Golden Palms Hotel & Spa, Bengaluru

CA Manoj Shah, President welcoming the delegates. Seen from L to R : Shri Devendra Mehta, CA Hinesh Doshi, Chairman, CA Rajesh Shah, Conference Co-ordinator, CA Rutvik Sanghvi, Convenor.

CA Hinesh Doshi Chairman, welcoming the delegates. Seen from L to R : Shri Devendra Mehta, CA Manoj Shah, President, CA Rajesh Shah, Conference Co-ordinator, CA Rutvik Sanghvi, Convenor

CA Manoj Shah, President inaugurating the Conference by lighting the lamp. Seen from L to R: S/Shri CA Anup Shah, Faculty, CA Yatin Desai, Vice President, Devendra Mehta, Convenor, CA Hinesh Doshi, Chairman, CA Rajesh L. Shah, Conference Co-ordinator, CA Rutvik Sanghvi, Convenor

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INTERNATIONAL TAXATION COMMITTEE – 2012-13

7th Residential Conference on International Taxation – 2013 held on 20th to 23rd June, 2013 at The Golden Palms Hotel & Spa, Bengaluru

Group photo of delegates

STUDY CIRCLE & STUDY GROUP COMMITTEE – 2012-13

Study Group meeting held on 28th June, 2013 on the subject "Recent Judgment under Direct Taxes"

Shri Nitesh Joshi, Advocate addressing the members.
Seen from (L to R) :
CA Ashok Sharma,
CA Dilip Sanghvi, Vice Chairman,
CA Manoj Shah, President,
CA Dinesh Shah, Convenor,
Shri Rahul Hakani, Faculty

ALLIED LAWS COMMITTEE – 2013-14

Study Circle Meeting held on 5th July, 2013 on the subject "Provisions relating to Tenancy including issues relating to Tenancies held by Partnership Firms, Companies & LLPs"

Mr. Divyakant Mehta, Advocate addressing the members.

INTERNATIONAL TAXATION COMMITTEE – 2012-13

Intensive Study Group on International Taxation held on 2nd July, 2013 on the subject "Evaluation Outbound and Overseas Structures"

Faculties

CA Shreyas Shah

CA Kartik Badiani

STUDY CIRCLE & STUDY GROUP COMMITTEE – 2012-13

Study Circle Meeting held on 11th June, 2013 on the subject "Taxation of Builders and Developers"

CA Jagdish Punjabi addressing the members

Study Circle Meeting held on 27th June, 2013 on the subject "Issues under capital gain – Sections 54, 54F, 54EC & Section 50C"

Shri Vipul Joshi, Advocate chairing the session

Shri Mandar Vaidya, Advocate addressing the session

Study Circle on International Taxation held on 17th June, 2013 on the subject "Taxation of Shipping Company"

CA Natwar Thakrar addressing the members. Seen from (L to R) : CA Haresh Kenia, Chairman and CA Ashok Sharma

STUDY CIRCLE & STUDY GROUP COMMITTEE – 2013-14

Lecture Meeting on E-filing of Income-tax Returns – Issues and Recent Developments jointly with Direct Taxes Committee held on 8th July, 2013 at the 4th Floor, Walchand Hirachand Hall, IMC

CA Yatin Desai, President welcoming the members. Seen from (L to R) : CA Haresh Kenia, Chairman, SC & SG Committee, CA Ameet Patel, Faculty

CA Ameet Patel addressing the members on the subject "E-Filing of Income–tax Returns – Issues and Recent Developments". Seen from (L to R) : CA Haresh Kenia, Chairman, SC & SG Committee, CA Yatin Desai, President, CA Ketan Vajani, Vice Chairman, Direct Taxes Committee

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