No. MCS/149/2016-18
R.N.I. No. MAHENG/2012/47041
Total Pages: 148

A Monthly Journal of
The Chamber of Tax Consultants

Price ₹ 100/- per copy

The Chamber's Journal

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

August - 2016 Vol . IV | No. 11

AUDITOR'S REPORTING RESPONSIBILITIES UNDER THE COMPANIES ACT, 2013

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DIRECT TAXES COMMITTEE

Lecture Meeting on "Income Declaration Scheme 2016 - Provisions and Issues" held on 5th August, 2016 At IMC.

CA Hitesh R. Shah, President delivering opening speech

CA Ketan Vajani, Chairman, Direct Taxes Committee welcoming the speakers.

Dr. K. Shivaram, Sr. Advocate and Past President addressing the delegates.

Shri D. C. Patwari, Principal Commissioner of Income Tax, Mumbai addressing the members.

Ms. Nishi Singh, Member, CBDT addressing the members.

Shri D. S. Saksena, Principal Chief Commissioner of Income Tax, Mumbai addressing the members.

CA Mahendra Sanghvi, Past President raising queries at the Question & Answer Session. Seen from L to R : S/Shri CA Ketan Vajani, Chairman, Direct Taxes Committee, CA Hitesh R. Shah, President, Ms. Nishi Singh, Member, CBDT, Dr. K. Shivaram, Senior Advocate and Past President, Shri D. S. Saksena, Principal CCIT, Mumbai and Shri D. C. Patwari, Principal CIT, Mumbai.

Section of Members

LAW AND REPRESENTATION COMMITTEE

Representation on Companies Amendment Bill 2016 on 12-7-2016 before Parliamentary Standing Committee on Finance chaired by Shri Veerappa Moily at Trident Hotel Nariman Point. Team was represented by CA Hitesh R. Shah, President, CA Hinesh Doshi, Hon. Jt. Secretary, CA Paras Savla, Co-Chairman of Law and Representation Committee, CA Jayesh Gandhi, Member.

90TH YEAR CELEBRATION COMMITTEE – 2016-17

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(Not in the picture : S/Shri Y. P. Trivedi, S. E. Dastur, Keshav B. Bhujle, Jayant P. Gokhale and Shailesh Bandi)

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Editorial

At last the Constitution (122nd) Amendment Bill is passed by the Parliament. Now the stage is set for Goods & Services Tax regime. This reform is a major step after the liberalisation in 1991. The fiscal laws should have the flexibility of getting adopted to changing times and the aspirations of the people. To put it in a simplistic manner, this should happen by default in a democracy. Unfortunately, in our country this particular reform which was accepted and endorsed by all political parties took ten years to roll out. Anyway, it is never too late. The Government's acid test on deliver ability starts now. The bureaucracy does not welcome change. Thus, the implementation will get staggered. If the Government is keen on efficient and expeditious implementation of the GST, then it should allow professionals to participate in the finalisation of delegated legislation. Otherwise, many rules and regulations will have to be brought on statute book on trial and error basis. We professionals are keenly observing and waiting for the actual roll-out of the Goods & Services Tax Act.

The Special Story of the August month's Chamber's Journal is on "Auditor's Reporting Responsibilities under the Companies Act, 2013". This Companies Act, 2013 also had many lives like a cat having nine lives. The Bill had repeatedly lapsed and in the year 2013 it saw the light of day. In spite of lot of back and forth on the Companies Bill, the final piece of statute which came out has not made happy either the industry or the professionals. The professionals strongly feel that too much discretion and power has been vested in the authorities without providing adequate accountability of that.

The Chairman of the Journal Committee Mr. Vipul Choksi has taken lot of pains to bring out this issue. I thank him for providing me all the help needed. I thank all the professionals who have contributed to this issue of the Chamber's Journal.

K. GOPAL
Editor

From the President

Dear Members,

India has completed 25 years of reforms which was initiated by Dr. Manmohan Singh, the then Finance Minister of India, in July 1991. India pawned Gold to deal with grim fiscal crisis to the world fastest growing economy. Once reforms have been initiated it needs to be continued and pace to be maintained. To continue with the reforms, during the year, the present Govt. has introduced **(i) Insolvency and Bankruptcy Code, 2106,** which will be critical in resolving India's bad debt problem which has crippled bank lending, **(ii) The Real Estate (Regulation and Development) Act, 2016** which will bring in clear accountability of builders and developers and protect interest of consumers/buyers, (**iii) Liberalised Foreign Direct Investment,** thereby allowing 100% FDI in Airlines, in broadcasting Carriage services, etc.

Further much awaited amendments to Constitution Bill for Goods and Service Tax (GST) i.e. Constitutional (122nd Amendment) Bill, 2014 **was passed in Rajya Sabha on 3rd August, 2016** after a long journey of 13 years as it was discussed in the Kelkar Task Force report on Indirect Taxes in 2003 for the first time and now it will be presented to Lok Sabha after incorporating necessary changes. It is a landmark legislation which will give further **impetus to ease of doing business in the world's fastest growing economy and will help in curbing the black money.** It is expected that **it will promote Make in India campaign, help exports and boost employment while providing enhanced revenue.**

GST will dramatically alter India's Indirect Tax structure by replacing a string of Central and local levies into one single unified tax and stitch to a common market i.e **One Nation, One Tax.** It is also imperative to have a robust country wide information Technology (IT) network infrastructure to make the implementation seamless. **GST will also be the best example of co-operative federalism or Pooled sovereignty without affecting the rights of the States.**

Now **real challenge** lies before the Government to bring out GST Act with the consensus of all States and make it effective from 1-4-2017. It is expected that **most services will become costlier** in short run and final impact on common man largely depends on final GST rate. Model law on GST hosted on Govt. website requires lot of changes and if implemented in same manner **will result in lot**

of litigation and turmoil. Hence it requires effective representation to be made by various stakeholders. The Chamber is also in process of making necessary representation requiring changes in Model GST laws. Professionals have greater role to play in implementation of GST and it will be emerging area of practice for professionals. The Chamber will also hold seminars and various workshops on GST.

July has always been busy month for all professional for filing return of income tax and everyone received some respite from CBDT which extended the deadline of filing returns up to 5th August, 2016.

At the Chamber, all committees are formed and respective meetings of the committees were held in the month of July, 2016. Each of the Chairman and the Core Committee members are enthusiastic about activities of the Chamber. Various innovative programmes have been planned for the year 2016-17.

The Chamber believes in effective representation before the regulatory authorities. Grievance Redressal is an essential component of democracy, every citizen should have their problems addressed and responded to. Good governance should be backed with accountability. Every Government officer should be made responsible and accountable for achieving good governance. Some efforts have been taken in this direction. However it is of utmost importance to implement robust Grievance Redressal system.

The Indirect Tax Committee Chairman Shri Vikram Mehta along with STPAM and WIRC representatives met the **Commissioner of Sales Tax Shri Rajiv Jalota** and appraised him of difficulties faced by dealers in filing VAT returns due to delay in MVAT automation programme. He has assured that necessary steps have already been taken to set right the system. According to him new automation is based on SAP system and various issues raised by stakeholders are being for the system Necessary clarifications have already been issued and in case of any problems one can approach VAT Department Officer who will be willing to help the people.

The Chamber made representation on Companies Amendment Bill, 2016 before **the Parliamentary Standing Committee on Finance chaired by Dr. Veerapa Moily** on 12th July, 2016. Hon. Jt. Secretary Hinesh Doshi was instrumental in organising the meeting. Despite short time granted, team Chamber led by Chairman of Corporate Committee Shri Bhavesh Vora jointly with Co-Chairman of Law and representation Committee Shri Paras K. Savla made effective representation on Companies Amendment Bill, 2016 on issues relating to Small and Medium Enterprises and on ease of doing business. Most of the suggestions made were appreciated by the Committee.

Law and Representation (L & R) Committee led by Chairman Shri Mahendra Sanghvi along with other organisations made representation on issues requiring certain clarifications on Income Declaration Scheme, 2016. As a result necessary

circulars/clarifications were issued by the CBDT. Further clarification have been sought by the joint team.

Chamber also organised its first lecture meeting on **Income Declaration Scheme 2016 (IDS) on 5-8-2016** which was **addressed by Senior Advocate Dr. K. Shivaram. CBDT Member Ms. Nishi Singh, Principal (Pr) Chief Commissioner of income Tax (CCIT), Mr. Saksena, Pr. Commissioner of Income Tax (CIT), Mr Patwari, other CCITs graced the occasion.** The CBDT Member Ms. Nishi Singh while addressing participants stated that the Income Tax Department is not looking IDS from revenue collection or meeting revenue targets. **An opportunity has been given through IDS to citizens to come out clean**. She further stated that the parallel economy is prevailing and their approach is to curb black money from the system so that developing economy can be fast converted into developed economy. Income Tax Department also gave presentation on IDS followed by interactive session on FAQs. Programme received a good response despite heavy rains. For the benefit of members presentation made will be posted on the Chamber's website. **Regulators have complimented the Chamber for intellectual discussion.** As requested by CBDT Member, Chamber will send the questions requiring clarification on IDS.

The current issue of Chamber's journal contains Special Story on 'Auditor's Responsibilities under the Companies Act, 2013. I compliment Chairman of Journal Committee Shri Vipul Choksi and his team for excellent coverage on the subject. I am sure this will help professionals to attain highest degree of responsibility while discharging this attest function.

Sports is necessity of life and this time more thrust has been given by Govt by sending 119 players to RIO for Olympic and has also increased budget to ` 125 crore. Chamber wishes all the best to all the players representing 125 crores Indians and I am sure they will bring pride to the nation.

Month of August/September are the months of festivals. Eid-ul-fitr, Raksha Bandhan, Gokulashtami, Paryushan, Parsi New Year, Ganesh Chaturthi, etc., will be celebrated by our fellow members as per their belief in different faiths. Though the faith may be different, the ultimate lesson of each faith is the same i. e. compassion, humanity, etc.

I, on behalf of all the members of Managing Council "WISH YOU ALL A HAPPY 70th INDEPENDENCE DAY".

JAI HIND

HITESH R. SHAH
President

Chairman's Communication

Dear Readers,

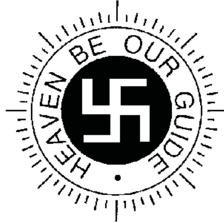
One of the most far-reaching tax reforms of India, GST has finally seen light of the day despite lot of initial hiccups! At least 15 or half of India's 29 States must ratify the bill and the Government targets getting that approval within 30 days as it chases April 1, 2017 deadline for implementation of GST. According to Prime Minister Narendra Modi, "GST is a Great Step towards Transparency," and GST will end Tax Terrorism. Professionals will have to now gear up to study the new law in right earnest. We shall come out with a special story on GST in due course of time.

As you are aware, there have been many changes in the Auditors' Reporting requirement under the Companies Act, 2013. Not only the reporting requirements have increased but the responsibilities also have increased manifold. Thus the auditing professionals are facing a challenging time. With the ensuing audit season around the corner, the committee thought it fit to bring this issue on 'Auditors' Reporting responsibilities under the Companies Act, 2013'.

In this issue, we have covered all the important aspects of reporting responsibilities including reporting under section 143(3)(i) regarding adequacy of internal financial controls (IFC) and its operating effectiveness which is applicable for reports issued for the year 2016. Reporting on IFC for a small and medium enterprise is a challenge and therefore we have covered one article from SME perspective. Standards on Auditing are mandatory but the Companies Act, 2013 too has made it doubly mandatory by virtue of provisions of sections 143(9) and 143(10). It is indeed difficult to cover all the auditing standards and therefore they have not been covered in this issue. I thank CA Hasmukh Dedhia for his valuable inputs in structuring the design of this issue.

This issue would not have been possible without the efforts of all the eminent authors who specialise in this subject and have dealt with the issues, relevant to the topic, in the best possible manner. Sincere thanks to them for their selfless efforts.

VIPUL K. CHOKSI
Chairman – Journal Committee



The Chamber of Tax Consultants

Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

CA Kamlesh S. Vikamsey

Auditor's Reporting Responsibilities – An Overview

1. Setting the context

1.1 In a more than a century old case Lopez L.J., deliberating on duties of auditors, ruled in favour of a company's auditors, that they are meant to carry out the role of "watchdogs", rather than "bloodhounds", and thus cannot be liable for any wrongdoings, which they had no reason to suspect in course of their audit [Kingston Cotton Mill Company (No.2) (1896)].

1.2 The rationale of that old ruling is only partly relevant in today's world of large sized organisations having huge public interest coupled with complex/global business structures. The periodic outcomes of large corporate scams and financial scandals have also growingly compelled the regulators / law-makers, world over, to constantly enhance auditors' reporting responsibilities and make their eligibility conditions more stringent so as to avoid any conflict of interest.

1.3 The separation of ownership and management of the business organisations as also wide variety of expectations from several stakeholders of such organisations including shareholders, employees, independent directors, lenders, suppliers, vendors, customers, regulating and revenue authorities etc. make the role of auditors of 'general purpose financial statements' more than just being confined to customary role of "watchdog".

1.4 India not being an exception to (i) emergence of numerous large organisations (ii) frequent corporate scams (iii) growing expectation gaps vis-a-vis role of the auditors, the Companies Act, 2013 ('the Act' or 'the new Act') has added significantly to responsibilities of auditors as also has made their eligibility conditions more stringent compared to Companies Act, 1956 ('the old Act'). Therefore, in this background, it is appropriate for preparers and auditors of the 'general purpose financial statements' to assess and evaluate the eligibility and reporting responsibilities of the auditors so as to substantially eliminate expectation gaps about the role and responsibilities of company auditors.

1.5 It is neither intended nor possible to summarise all the relevant developments taking place in this write-up; the special issue contains several important sub-topics in the matter for dealing with them in detail. Only an attempt is made to summarise some major continuing challenges and recent significant developments taking place in respect of Auditor's reporting responsibilities

2. Major changes in the Act enhancing Auditor's Reporting Responsibilities

2.1 The auditor of holding company has been given right of access to the records of subsidiaries in connection with their audit of Consolidated Financial Statements ('CFS')

[proviso to section 143(1)]. The auditors of holding company may have to decide, based on facts of each case as to when and how to exercise such right, which is now specifically given to them under the Act. In this matter, provisions of SA 600 should be referred to by the auditors with guidance pertaining thereto. ICAI has also recently issued Guidance Note on audit of CFS which would also be useful reference for auditors of CFS.

2.2 Cash flow statements have now been made part of the financial statements and every company, unless exempted, is required to prepare and present the same as part of financial statements; audit of cash flow statement in case of unlisted and other companies, which were hitherto not required to prepare the same, is obviously an additional responsibility of the auditors. The listed companies are mandated to prepare cash flow statement by SEBI under 'indirect method'. Whereas, the other companies to whom cash flow is now made applicable under the Act, have a choice of preparing the same under one of the two methods (direct OR indirect) as prescribed in AS-3.

2.3 Reporting on Internal Financial Controls ('IFC') by the auditors is a significant additional requirement. The Board of Directors of listed companies are mandated to report on IFC as defined in Section 134 whereas in case of other companies, [under Rule 8(5) of Companies (Accounts) Rules, 2014] such reporting is required on 'Internal Controls over Financial Reporting' (ICFR). The major difference between IFC and ICFR, as explained in the guidance note on the matter issued by ICAI, is that IFC contains reporting on 'orderly and efficient conduct of business' in addition to reporting on matters pertaining to ICFR. The auditors need to opine in their report on adequacy as well as operating effectiveness of such internal controls over financial reporting.

There could be challenges in this respect especially in relation to Small and Medium sized companies and for that matter also in relation to large unlisted but owner managed public companies. The policies and procedures for key business areas, transaction processing and identification of risks associated therewith in such companies may not be fully documented and tested internally for its effectiveness. The framework benchmarking for 'control self-assessment' processes and mind-set for such procedures may need to be imbibed across various operational areas by many companies. The auditors need to follow the procedures and guidelines narrated in the Guidance Note of ICAI; if the results of such verifications reveal control design weaknesses or areas needing improvements for enhancing the operating effectiveness, the report on ICFR may have to be suitably modified. Needless to add that appropriate documentation of the verification processes including sample size and manner of checking must be maintained by auditors in self-explanatory manner.

2.4 Section 143(3)(j) read with Rule 11 of Companies (Audit and Auditors) Rules, 2014 require the auditors of companies to report upon three additional matters as mentioned in the rules which pertain to (i) timely transferring of funds by company to Investors Education and Protection Fund; (ii) Impact on financial statements, if any, of the pending legal cases; (iii) Impact on financial statements, if any, of long term contracts, including derivatives.

2.5 Compliance by Company auditors to Standards on Auditing ('SA') is made mandatory by section 143(9). Though, SAs were and are mandatory to all attest functions under ICAI literature, for the first time SAs have been referred to in Act. Compliance to all SAs therefore assume significant importance in case of audit of a company. The findings of Peer Review Board of ICAI seem to suggest significant scope for improvements in relation to maintenance of appropriate documentation to display and evidence the compliance to SAs by the audit firms in India.

2.6 In terms of powers conferred to the Central Government u/s. 143(11), it has issued

Companies (Auditor's Report) Order, 2016 ('CARO 2016') which is applicable to all the audit reports for the financial years commencing on or after April 1, 2015. CARO-2016 contains several reporting requirements which are new and additional compared to its earlier version. ICAI has issued Guidance Note on CARO, 2016, which would provide useful guidance to all concerned.

In course of verification work for reporting under CARO-2016, the auditor is expected to use his professional skills and subjective assessment using judgmental abilities in number of matters e.g., (i) reporting of compliance u/ss. 185 and 186 of the Act (ii) reporting of compliance with Companies Acceptance of Deposits Rules, (iii) reporting about transactions of loans, sale/purchase/services with related parties, (iv) reporting whether the company needs to be registered u/s. 45IA of RBI Act or not, (v) reporting about title deeds in case of immovable properties held by the company as fixed assets.

2.7 Section 143(12) imposes a significant additional reporting responsibility on company auditors. If any auditor, in course of the performance of his duties as auditor, has reason to believe that an offence involving fraud is being or has been committed against the company by officers or employees of the company, he shall report the matter to the Central Government in the prescribed manner. This requirement is also applicable to cost auditor as well as company secretary carrying on secretarial audit. This additional requirement manifests growing expectations of Government and other stakeholders from the auditors. Again, for such onerous reporting responsibility, a Guidance Note by ICAI is available, the guidance whereof should be fully used by the auditors of the company in carrying on this duty of reporting about fraud. The procedures suggested in SA 240 and SA 315 should be skillfully employed in course of the audit with professional skepticism to combat any risk of later being alleged of negligence or misfeasance.

The term 'fraud' is not defined in Section 143(12) but it is defined in Section 447 of the Act, though for the purposes of that Section only, it can be referred to by the auditor for better understanding of legislative intent. Accordingly, fraud in relation to affairs of a company includes any act, omission, concealment of any fact or abuse of position by any person committed or in connivance with any other person in any manner with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, regardless of the fact whether there is any unlawful gain or unlawful loss.

The lengthy definition of 'fraud' in section 447 is inclusive; therefore, which instances to be covered by the reporting u/s. 143(12) and manner of reporting etc., need to be carefully considered by the company auditor; these matters have been dealt with in the Guidance Note of ICAI, which can be referred to in course of determination of reporting issues.

3. Other changes with reference to audit and auditors

3.1 Section 144 lists out services which cannot be provided by the company auditors, directly or indirectly; this is enacted with a view to eliminate the conflicts in the role and responsibilities of company auditors. Though, most of these services were also prohibited under code of ethics of ICAI, the inclusion thereof in the law underlines the importance about maintenance of independence and conflict-free status of the auditors. The list of prohibited services includes "management services". It is not clarified as what all is meant by the term management services. The code of ethics of ICAI contains reference to 'Management Consultancy Services' which is not necessarily same as 'management services'.

Further, under ICAI regulations, the cap on fees for the services, other than audit, provided by the auditor of public company (assuming that such services are permissible) is fixed at

100% of the audit fees excluding the fees for those services which are statutorily required to be provided by the statutory auditors. Such restrictions should also be duly adhered to by the company auditors.

3.2 One of the eligibility conditions for being appointed as company auditor, prescribed u/s. 141(3)(e), prohibits auditor or firm from having any 'business relationship' with the company or with its subsidiary, holding, associate, fellow subsidiaries. For this purpose, 'business relationship' is construed as any transactions of commercial nature other than (i) transactions which are in nature of professional services permitted to be rendered under Chartered Accountants Act, 1949 and rules/regulations made thereunder, and (ii) transactions of sale/purchase of good/services in ordinary course of business of the company at arm's length price e.g., purchase by auditor of services like telecom, power, hospitals, hotels and similar businesses

3.3 The Act brings in significant change by providing for appointment of auditors for tenure of 5 consecutive years and also by providing about rotation of auditors beyond the two terms of five years each. For counting this maximum number of years, the tenure of auditors in past (i.e., prior to the Act becoming effective) is also to be considered i.e., retrospective. The transition time of three years is given by the Act to the existing companies to be compliant with provisions of Section 139(2) pertaining to appointment/rotation of auditors. Earlier confusion prevailed about counting of such transition period of three years, from the date Section 139 became effective, because of the language of Section 139(2) – third proviso. This has been clarified by the MCA recently to state that last year of transition period would be financial year 2016-17 and in the AGM to be held in the year 2017, the existing auditor of the company should be rotated out.

3.4 Although, not directly linked to the reporting responsibilities but above stated and several other changes brought in the Act need careful analysis by the present as well as proposed auditors of the companies before the engagement is executed.

4. Initiatives by 'Institute of Chartered Accountants of India' ('ICAI')

4.1 ICAI as apex body regulating the profession of Accountants in India generally takes pro-active steps in guiding its members on several issues arising either because of the amendments in the law or due to any changes taking place affecting the work/role of auditors. The representations made by ICAI to MCA and other authorities pertaining to several amendments introduced in the new Companies Act have resulted in good amount of clarifications and/or relaxations in the Act/Rules. Issuance of several guidance notes by ICAI on additional reporting requirements mandated in the Act [e.g. on IFC, on Reporting about fraud, on CARO etc.] provide useful guidance to members and to the companies in carrying out their respective duties. Further, several technical guides on specific industries or specialised audits are also issued by ICAI which are also practically useful to the auditors. Host of other literature of ICAI like EAC opinions, Peer review findings etc. could be fruitfully referred to by the company auditors in pursuit of enhancing the audit quality.

4.2 The SAs issued by ICAI have been notified under the Act in terms of provision of Section 143(10). ICAI continuously endeavours to update the SAs in line with International Standards on Auditing. The implementation guides thereon issued by ICAI provide very useful guidance to those concerned.

The report of the auditors to the shareholders is an important communication signifying outcome of the auditing process not only to the shareholders but also to all the stakeholders. As far as the format of audit report is concerned, provisions of SA 700, 705 and 706 should be examined in detail by the company auditors for guidance about modifications, emphasis matters as well as other matters to be contained in the audit report. Further, the auditor's ongoing

communications with Board of Directors or Audit Committee i.e., those Charged with Governance ('TCWG') forms an important part of contemporary audit practice.

The need for adequate and appropriate documentations can never be over emphasised. Depending on facts of each case, one can generalise that audit documentation containing following items could be considered as appropriate: (i) the audit plan and programme, (ii) terms of engagements executed with the auditee, (iii) risk and materiality assessments, (iv) record of analytical and substantive audit procedures, (v) sampling methods and details thereof, (vi)external confirmations, (vii) representations furnished by the auditee, (viii) check-lists recording compliance points under the Act, Schedule III, CARO, accounting standards and other such matters, (ix) minutes or records of discussion with company management about audit observations, (x) consultations sought and obtained, if any, on contentious matters, (xi) internal discussions between audit manager or team with engagement partner/QC etc.

4.3 Another matter which has invoked public interest and debate over last few years is that of Auditor's Independence. It essentially implies independence of auditors from parties that might have a financial interest in the business being audited. Thus, independence not only with reference to the entity being audited but with all the parties/stakeholders who may have financial interest in the business of the auditee is expected. It is of paramount importance for the auditors not only to maintain independence but also to be seen as such.

Code of Ethics of ICAI refers to

(i) **Independence of mind:** The state of mind that permits providing of an opinion without being affected by influences that compromise professional judgment, allowing auditors to act with integrity and exercise objectivity and professional skepticism, AND

(ii) **Independence in appearance:** The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude that a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

5. Other connected matters

5.1 The inquiries to be made by the auditors in terms of items listed in Sections 143(1)(a) to (f) [corresponding to section 227(1A) of the old Act] are also to be kept in mind by the auditors for necessary action. These are such items which are to be contained in the audit report only if some adverse remark or qualificatory observation is noticed as result of conducting such inquiries.

5.2 From the Financial Year 2016-17, Indian Standards converged with IFRS i.e., Ind-AS which would be effective for listed and other entities having net worth of ` 500 crore or more as on March 31, 2014. This would entail several other additional reporting requirements for which auditing professionals would have to be geared up.

6. Conclusion

The propriety aspects of the transactions covered by audit are gaining importance as can be noticed from several additional reporting requirements like reporting on some items of CARO, ICFR etc.; auditors need to constantly remind themselves to overcome some natural tendencies—such as overreliance on client representations and avoid biases. They need to approach the audit with a skeptical attitude and questioning mind. To overcome familiarity threat, auditors must set aside past relationships and not assume that all clients are honest. The new reporting regime requires auditors to learn how to adopt a more critical, skeptical mind-set on their engagements, particularly during audit planning and the evaluation of audit evidence.

CA Atul H. Shah

Regulatory reporting requirements (other than IFC and Fraud reporting) under the Companies Act, 2013

1 Fundamental reporting requirements of an auditor

The primary responsibility of an auditor, appointed in accordance with the provisions of Section 139 of the Companies Act, 2013 (CA 2013) is to make a report on every financial statements which are laid before the company in general meeting to the members of the company. In terms of provisions of section 143(2) of CA 2013, auditor is required to report that the accounts, financial statements audited by him give a true and fair view of the state of the company's affairs as at the end of its financial year and profit or loss and cash flow for the year. Such reporting by the auditor should be after taking into account the provisions of CA 2013, the accounting and auditing standards and matters which are required to be included in the audit report under the provisions of CA 2013 and rules made thereunder.

1.1 These requirements under section 143(2) of CA 2013 are in line with what was prescribed under the provisions of the Companies Act, 1956 (CA 1956), except the following:

1.1.1 As per section 129(3) of CA 2013, a company having subsidiary / joint venture / associate (subject to certain relaxations) is required to prepare consolidated financial statements (CFS) and lay before its annual general meeting along with the laying of its standalone financial statements. Considering the provisions of Section 143(2) of CA 2013, it implies that the auditor is also required to make a report on such CFS. Accordingly, the earlier practice followed by certain companies of appointing a different firm of chartered accountants, other than statutory auditor, as auditor of CFS would not be possible where CFS is required to be prepared under CA 2013.

1.1.2 The auditor is now supposed to comply with the Standards of Auditing (SAs) prescribed by the Central Government under section 143(10) of CA 2013. Prior to this change, the Institute of Chartered Accountants of India (ICAI) was the governing authority to prescribe the SAs. Accordingly, in the Auditor's Report after CA 2013, while explaining the Auditor's Responsibility in the auditor's report, reference is required to be given to the section 143(10) of CA 2013.

1.1.3 The definition of "Financial Statements" was incorporated in CA 2013 and it inter alia includes Cash Flow Statement. Since there was no such definition under CA 1956, presentation of Cash Flow Statement was governed by the classification of company under the Companies (Accounting Standards) Rules, 2006. However, after the above change, applicability of preparation and presentation of Cash Flow Statement is governed by the provisions of Section 2(40) of CA 2013..

2. Reporting duties of an auditor u/s. 143 of CA 2013

- o Section 143 of CA 2013 provides for powers as well as reporting duties of auditors.

Similar provisions were contained in section 227 of CA 1956. This article covers the changes relating to reporting requirements brought in by CA 2013.

o Reporting requirements in terms of Section 143(3)(i) relating to Internal Financial Controls over Financial Reporting, Section 143(11) relating to Companies (Auditor's Report) Order, 2016 and Section 143(12) relating to Frauds are separately covered in this issue and hence not discussed in this article.

2.1 Reporting requirements under section 143(1) of CA 2013

2.1.1 This sub-section requires auditor to inquire into matters listed out therein and report to the members if there are any adverse observations. The matters covered in the sub-section are:

(a) *Whether loans and advances made by the company on the basis of security have been properly secured and whether the terms on which they have been made are prejudicial to the interests of the company or its members*

(b) *Whether transactions of the company which are represented merely by book entries are prejudicial to the interests of the company*

(c) *Where the company not being an investment company*[1] *or a banking company, whether so much of the assets of the company as consist of shares, debentures and other securities have been sold at a price less than that at which they were purchased by the company*

(d) *Whether loans and advances made by the company have been shown as deposits;*

(e) *Whether personal expenses have been charged to revenue account*

(f) *Where it is stated in the books and documents of the company that any shares have been allotted for cash, whether cash has actually been received in respect of such allotment, and if no cash has actually been so received, whether the position as stated in the account books and the balance sheet is correct, regular and not misleading.*

2.1.2 There is no change in the reporting requirements prescribed in the Section 143(1) of CA 2013 from what was required to be reported under section 227(1A) of CA 1956. However, since the auditor is required to report on CFS also, he has been empowered with right of access to the records of all subsidiaries of the company in so far as it relates to CFS. This implies that the auditor should access the records of the subsidiaries in the event he is of the view that his audit procedures would be incomplete unless he has reviewed the records of the subsidiaries. Accordingly, it is more of an obligation than a right.

2.2 Reporting requirements under section 143(3) of CA 2013

Unlike the requirements of section 143(1) of CA 2013, where the auditor is required to inquire and report only if he has comments or observations, the auditor must include matters stated in section 143(3) of CA 2013 in his report. The matters covered in the sub-section are:

2.2.1 Section 143(3)(a) – The auditor's report shall state: *Whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements*

The only difference with respect to corresponding provisions of CA 1956 is addition of words, which are underlined. The auditor is now duty bound to give details as well as effect of information or explanations inquired by him but not furnished to him.

2.2.2 Sections 143(3)(b) to (e) deal with matters relating to maintenance of books of account; branch returns and its audit; manner of dealing with report of the branch auditor; compliance with

1 Under CA1956, it was stated that meaning of Investment Company should be as per section 372. There is no such reference in CA2013. However, in absence of any specific definition provided in the Act, one can refer to meaning provided in section 186 of CA2013 for the purpose of that section.

accounting standards and finally ultimate question to auditor – whether financial statements are in agreement with books of account. These matters are same as per earlier reporting requirements under CA 1956.

2.2.3 Section 143(3)(f) – The auditor's report shall state: *The observations or comments of the auditors on financial transactions or matters which have any adverse effect on the functioning of the company*

Under CA 1956, section 227(3)(e) provided that auditor's observations which have any adverse effect on the functioning of the company should be stated in thick type or in italics in his report. There is no such requirement under CA 2013. However, auditor is required to specifically report on financial transactions or matters, which have any adverse effect on the functioning of the company. The earlier requirement was restricted to matters, which are otherwise covered in the report; while the new requirement mandates the auditor to specifically state in his report the financial transactions or financial matters which have any adverse effect on the functioning of the company.

ICAI has issued a Guidance Note on Reporting under Sections 143(3)(f) and (h) of CA 2013 (GN). The guidance provided in the GN relating to this clause is summarised hereunder:

(a) Insertion of this clause as part of the reporting requirement does not intend to change the basic objective and the concept of audit of financial statements of a company. The scope of the audit and auditor's role remains as contemplated under the Standards on Auditing.

(b) The Act does not specify the meaning of the phrase 'adverse effect on the functioning of the company'. The expression should not be interpreted to mean that any event affecting the functioning of the company, observed by the auditor, should be reported upon even though it does not affect the financial statements, e.g., revocation of a licence to manufacture one out of the many products.

(c) The words "observations" or "comments" as appearing in this clause are construed to have the same meaning as referring to "emphasis of matter" paragraphs or situations leading to modification in the auditor's opinion. Accordingly, if the matter leading to the modification of the auditor's opinion or an emphasis of matter in the auditor's report on financial statements is likely to have an adverse effect on the functioning of the company, the auditor is required to report such matter.

(d) Only such matters, which in the opinion of the auditor have an adverse effect on the functioning of the company, should be reported under this clause. Conversely, such qualifications or adverse opinions or disclaimer of opinion or emphasis of matters of the auditor, which do not deal with matters that have adverse effect on the functioning of the company, need not be reported under this clause. Auditor will need to apply professional judgment in considering matters that may have an adverse effect on the functioning of the company. Ordinarily matters that are pervasive in nature such as going concern or matters that will significantly impact the operations of the company due to its size and nature will need to be reported under section 143(3)(f) of CA 2013.

Examples:

o The adoption of going concern assumption is appropriate but there are several factors leading to a material uncertainty that may cast a significant doubt about the company's ability to continue as a going concern

o A material uncertainty regarding the outcome of a litigation wherein an un-favourable decision could result in a significant outflow of resources for the company

Examples of emphasis of matter, which may not have an adverse effect on the functioning of the company, is a situation where there is an emphasis of matter on managerial remuneration which is subject to the approval of the Central Government.

(e) If any observations or comments made by the auditor on the adequacy or operating effectiveness of internal financial controls over financial reporting contain such matters, which, in his opinion, may have any adverse effect on the functioning of the company, should also be reported under section 143(3)(f) of CA 2013, even if such observation did not result in a modification to the audit opinion on the financial statements of the company. An example in this regard may be where an auditor reports that the company did not have an appropriate internal control system for inventory with regard to receipts, issue for production and physical verification.

Based on the GN, it is clear that the question of reporting under section 143(3)(f) of CA 2013 will arise only if the auditor has issued modified opinion or has emphasised on a matter which has been stated in the financial statements and such matter has adverse effect on the functioning of the company. In addition, the auditor should also consider reporting under this clause if he has observations or comments relating to Internal Financial Control over Financial Reporting.

2.2.4 Section 143(3)(g) – The auditor's report shall state: *Whether any director is disqualified from being appointed as a director under sub-section (2) of section 164*

(a) *Vide* this clause, responsibility has been cast on the auditor to verify and state in his audit report as to whether any director of the company whose accounts are under audit with him is disqualified from being appointed as Director by virtue of non-compliance of certain statutory obligations by any other company of which also he is a director.

(b) The sub-section of section 164(2) of CA 2013 reads as under:

(2) No person who is or has been a director of a company which—

(a) Has not filed financial statements or annual returns for any continuous period of three financial years; or

(b) Has failed to repay the deposits accepted by it or pay interest thereon or to redeem any debentures on the due date or pay interest due thereon or pay any dividend declared and such failure to pay or redeem continues for one year or more, shall be eligible to be re-appointed as a director of that company or appointed in other company for a period of five years from the date on which the said company fails to do so.

(c) In the Guidance Note issued by ICAI[2], it has, inter alia, been laid down that:

- Disqualification is required to be tested as at the Balance Sheet date.
- Section 164(2) of CA 2013 is applicable to appointment of directors both in public and private companies.
- In case of disqualification by virtue of section 164(2)(a), the period of 5 years would be reckoned from the date as specified in sub-clause (a), on which the company failed to file its annual accounts and Annual Returns.
- Where the disqualification arises on account of section 164(2)(b), the period of five years will be reckoned from the relevant due date as specified in sub-clause (b) for repayment of deposit or interest thereon or

2 Guidance Note on Section 227(3)(e) and (f) of CA1956

redemption of debentures or payment of dividend, as the case may be.

This would mean that while reporting on the financial statements of a particular year, the auditor will have to ascertain whether a person appointed as director in the auditee company was not a director of another company which has defaulted in terms of section 164(2) of CA 2013 during the last five years.

(d) For the purpose of his reporting, the auditor should require the director to submit a written representation in respect of each such company as on the balance sheet date, as to whether or not the companies of which also he is a director have not defaulted in terms of section 164(2). In addition, the auditor should also obtain written representation on the same lines from the director in respect of each of those companies in which he was a director.

(e) The auditor should insist that written representations of directors should be taken on record by the Board of Directors of the auditee company.

(f) In case an auditee company has not filed the annual accounts and annual returns for any continuous three financial years commencing on and after April 1, 2014; or has failed to repay its deposit or interest thereon on due date or redeem its debentures on due date or pay dividend and such failure continues for one year or more; then the auditor must report that all the directors are disqualified from being appointed as director in terms of section 164(2) of CA 2013.

2.2.5 Section 143(3)(h) – The auditor's report shall state: *Any qualification, reservation or adverse remark* ***relating to the maintenance of accounts and other matters connected therewith***

This clause has also been dealt with in the GN (referred to in para 2.2.3 above). The guidance provided therein is summarised hereunder:

(a) The words "qualification", "adverse remark" and "reservation" used in section 143(3)(h) should be considered to be similar to the terms "qualified opinion", "adverse opinion" and "disclaimer of opinion", respectively, referred to in SA 705 "Modifications to the Opinion in the Independent Auditor's Report".

(b) Any matter that causes a qualification, adverse remark or disclaimer of opinion on the financial statements may warrant reporting under section 143(3)(h) since such matters will or possibly will have an effect on the books of account maintained by the company.

(c) Reporting under this clause will also be required if the auditor makes any observation under section 143(3)(b) relating to whether proper books of account as required by law have been kept by the company.

(d) As a corollary, reporting under this clause will not be required if there are no modifications, i.e., no qualified, adverse or disclaimer of opinion, and there are no such observations under section 143(3)(b) of CA 2013 regarding books of account kept by the company.

(e) Matter reported under emphasis of matter paragraph in the audit report need not be considered for reporting under this clause as an emphasis of matter, is not in the nature of a qualification, reservation (disclaimer) or adverse remark.

(f) Any material weakness in internal financial controls that is reported by the auditor under section 143(3)(i) of CA 2013 may not have an impact on the maintenance of books of account if such material weakness did not result in a modification to the opinion on the financial statements of the company. However, if the material weakness in internal financial controls resulted in a

modification to the audit opinion on the financial statements, then such modification may be covered for reporting under this clause.

2.2.6 Section 143(3)(i) – The auditor's report shall state: *Whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls;*

This has been covered separately in this issue of the Journal and hence not repeated here. Necessary guidance may be obtained from the separate article.

2.2.7 Section 143(3)(j) delegates power to the Central Government to prescribe matters to be included in auditors report. Based on the same, *vide* Rule 11 of the Companies (Audit and Auditors) Rules, 2014 following matters have been prescribed and the auditor is required to include their views and comments thereon in his report.

2.2.7.1 *Whether the company has disclosed the impact, if any, of pending litigations on its financial position in its financial statement*

(a) It has not been clarified whether the reporting requirement is relating to litigations against the company or it extends even to litigations initiated by the company on third parties. However, from the published results for last two years, it has been observed that the auditors have reported on litigations against the company only. Litigations by the company would be generally in the nature of Contingent Asset which is anyway prohibited from recognition and disclosure of the same in the financial statements is not encouraged in terms of Accounting Standard 29: 'Provisions, Contingent Liabilities and Contingent Assets' Therefore, the beneficial interpretation would be litigations against the company.

(b) Considering the principles laid down in AS 29 and disclosure requirements prescribed in Schedule III to CA 2013, the company is required to analyse the facts of each case of pending litigation. Based on such analysis, the company is required to identify whether the claim made by third party needs to be treated, fully or partially, as liability or provisions and/or disclosed as contingent liability.

(c) Paras 66 to 72 of AS 29 deal with disclosure requirements for items treated as provisions and contingent liabilities. In addition, para 6T of Part 1 – General Instructions for Preparation of Balance Sheet of Schedule III to CA 2013 prescribes inter alia disclosure requirements relating to Contingent Liabilities. It should be noted that, under Schedule III, details of 'claims against the company not acknowledged as debts' are required to be disclosed. A company may be of the view that claims made by a party by initiating litigation is frivolous and has absolutely no merit; then also in view of above disclosure requirements of Schedule III, it should be disclosed.

(d) In addition to above, there could be litigations having no financial claim and hence may not come under preview of AS 29 e.g. litigation restraining the company from using a particular trade mark. However, disclosure of such litigations would fall under the scope of reporting requirements specified above *vide* Rule 11.

2.2.7.2 *Whether the company has made provision, as required under any law or accounting standards, for material foreseeable losses, if any, on long-term contracts including derivative contracts*

This reporting requirement does not cast any additional burden on the auditor, except separate confirmation in his report, as he is otherwise also required to verify and comment on compliance with accounting standards as well as Announcement of ICAI of March 2008 dealing with accounting of derivative contracts. The scope of this clause also requires reporting on probable losses arising out of long-term supply

contracts where cancellation would incur penalty and supply would result in losses. The auditor should make necessary enquiries and obtain representations from the management on this aspect.

2.2.7.3 *Whether there has been any delay in transferring amounts, required to be transferred, to the Investor Education and Protection Fund by the company*

(a) Section 125 of CA 2013, which deals with Investor Education and Protection Fund (IEPF) was notified on January 13, 2016. Prior to that date, the provisions of Section 205C of CA 1956 were in force. As per these provisions, following amounts, if remained unclaimed and unpaid for a period of seven years from the date they became due for payment, are required to be credited (along with accrued interest) to the IEPF:

- o Unpaid dividend accounts of the companies;
- o Application moneys received for allotment of any securities and due for refund;
- o Matured deposits;
- o Matured debentures;
- o Sale proceeds of fractional shares arising out of issuance of bonus shares, merger and amalgamation
- o Redemption amount of preference shares

(b) Auditor is required to verify status of aforementioned balances and report to the members whether the same have been transferred to IEPF in time or not. The reporting requirement here is to report on the delay in transferring the amount to the IEPF.

2.3 Negative or qualified observations

Section 143(4) of CA 2013 provides that the auditor should state reasons in his report where any of the matters required to be included in the audit report under section 143 of CA 2013 is answered in the negative or with a qualification.

2.4 Penalty provisions

2.4.1 If an auditor of a company contravenes any of the provisions of section 143 of CA 2013, he shall be punishable with minimum fine of ` 25,000 which may extend to ` 5 lakh. If it is found that the auditor has contravened those provisions knowingly or wilfully with the intention to deceive the company, its share holders, creditors or tax authorities, he is liable to punishment with imprisonment for a term up to one year and with a minimum fine of ` 1 lakh which may extend up to ` 25 lakh.

2.4.2 If any auditor is convicted of an offence as stated above, he shall be liable to (a) refund the remuneration received by him to the company and (b) pay for damages to the company, statutory bodies/authorities or to any other persons for loss arising out of incorrect or misleading statements of particulars made in his audit report.

2.5 Reporting requirements for Consolidated Financial Statements

The reporting requirements discussed in this article would also be applicable in case of auditor's report on Consolidated Financial Statements.

2.6 Conclusions

The users of the audited financial statements generally do not appreciate the inter-relationship between the responsibilities of those who prepare the financial statements and those who audit them. Accordingly, many a times the nature and context of the opinion expressed by the auditors are not understood and also misinterpreted. In view of the same, it is utmost important that users as well as auditors clearly understand reporting requirements under the relatively new statute.

CA Ashesh Jani

Standards on Auditing on Audit Report : SA 700, 705, 706

Importance of an Auditor's report on Financial Statements

The importance of credible financial reporting in today's era simply cannot be undermined from the perspective of the intended users of the financial statements – be it the creditors, the investors, the regulators or the Government agencies and all others who have a direct or indirect stake or interest in the state of affairs of the entity. The independent auditor's report greatly enhances the degree of confidence of the users in the financial statements of an entity and lends credibility to such financial statements which are then relied upon by the various stakeholders.

For the audit reports to serve a meaningful purpose, it is imperative that they convey the auditor's opinion on the financial statements in a very clear and unambiguous manner. Uniformity and comparability in their format and content are also very important considerations which enhance the usability and value of the audit reports for the users.

SAs 700, 705 and 706

Keeping in mind the importance of an Auditor's report on Financial the Institute of Chartered Accountants of India (ICAI), in 2010, issued three separate Standards on Auditing (SA) to deal with the form and content of an independent auditor's report as also the various types of opinions and other matters that may be included in the auditor's report. These Standards are, SA 700 on Forming an Opinion and Reporting on Financial Statements; SA 705 on Modifications to the Opinion in the Independent Auditor's Report; and SA 706 on Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report. These SAs are collectively known as 'the Reporting Standards'. All the three SAs are very comprehensive and in harmony with the corresponding International Standards on Auditing issued by the International Auditing and Assurance Standards Board.

While the SAs 700, 705 and 706 were originally effective for audits of financial statements beginning on or after April 1, 2011 when issued, the ICAI in its meeting held in December, 2009 postponed their effective dates by one year i.e. for audits of financial statements for periods beginning on or after April 1, 2012.

Standard on Auditing (SA) 700 – Forming an Opinion and Reporting on Financial Statements

Introduction

The title of SA 700 can be slightly misleading in that it does not give an indication that one may also need to look at other SAs e.g. SA 705 if the opinion is modified or SA 706 contains

an emphasis of matter and/or other matters paragraph. However, SA 700 lays down the basic principles of reporting and the others SAs like SA 705 and 706 then draw upon such principles for reporting in special circumstances. SA 700 deals with an unmodified audit opinion, i.e. what is commonly known as a 'clean report'.

It is pertinent to bear in mind that SA 700 applies only to 'audits' and not to engagements in the nature of 'limited reviews' or 'compilations' or 'agreed-upon procedures', which are addressed by other SAs. Similarly SA 800 deals with auditor's report on financial statements which are prepared in accordance with a special purpose framework and SA 805 deals with auditor's report on a single financial statement or of a specific element, account or item of a financial statement.

Key Concepts

General purpose financial statements

SA 700 deals with general purpose financial statements i.e. those which are prepared in accordance with general purpose framework. In simple words, general purpose financial statements normally comprise a balance sheet, statement of profit and loss (or income statement), cash flow statement, significant accounting policies and notes, and where applicable, statement of changes in equity.

General purpose framework

A general purpose financial reporting framework is a framework designed to meet the basic financial information requirements of a wide range of users. The reporting framework may be either in form of a fair presentation framework or a compliance framework. A fair presentation framework where the management has the freedom to (a) provide disclosures beyond those that are mandated by the framework or, (b) in extremely rare cases, to even depart from the requirements of the framework in order to achieve a true and fair presentation. The auditor gives a 'true and fair' report in such a case. A compliance framework, on the other hand, requires meeting the requirements of the framework but does not give management such freedom and the auditor reports on whether the financial statements comply with the requirements of the applicable laws, rules etc. For example, an auditor of a Non-Banking Finance Company (NBFC) which is regulated by the Reserve Bank of India (RBI), is required to report on (a) whether the financial statements of the NBFC gives a true and fair view of the entity's financial position, performance and cash flows (fair presentation framework) and (b) whether the financial statements comply with RBI rules (compliance framework).

Requirements of SA 700

The auditor is required to form an opinion on whether the financial statements are prepared, in all material respects, in accordance with the applicable financial reporting framework. In forming this opinion, the auditor is also required to consider the qualitative aspects of entity's accounting policies and possible bias in management's judgments and estimates.

Further, the auditor is required to conclude as to whether reasonable assurance has been obtained about whether the financial statements are free of material misstatements due to Fraud or Error taking into account (a) Sufficiency and appropriateness of audit evidence – SA 330 and (b) Whether uncorrected misstatements are material, individually or in aggregate – SA 450

In particular, the auditor is required to evaluate whether –

i. The financial statements adequately disclose the significant accounting policies selected and applied and whether they are consistent with the applicable financial reporting framework and are appropriate;

ii. The accounting estimates used by the management are reasonable;

iii. The Information presented in the financial statements is relevant, reliable, comparable and understandable;

iv. The financial statements provide adequate disclosures to enable users to understand the effect of material transactions and events and the terminology used in the financial statements is appropriate.

Form of Opinion

The auditor is required to express an unmodified opinion when the auditor concludes that the financial statements have been prepared as per the applicable financial reporting framework.

If the auditor concludes, based on audit evidence obtained, that the financial statements are not free from material misstatements or the audit evidence obtained is not sufficient to conclude that the financial statements are free of material misstatements, the auditor is required to express a modified opinion. The modified opinion is discussed in detail under the SA 705 section below.

Contents of Auditors' Report

Auditor's report is required to be in writing and the following are required to be included in the standard report issued –

- Title, Addressee, Report on Standalone or Consolidated financial statements.
- An Introductory paragraph stating the name of the Company, that the financial statements have been audited, title of each statement that forms part of financial statements, reference to significant accounting policies and the period covered by the audit.
- The Management's Responsibility paragraph describing the responsibilities of those in the organisation that are responsible for the preparation of financial statements. Management's responsibility amongst other things includes design, implementation and maintenance of internal control that the financial statements are free of material misstatements due to fraud or error.
- Auditor's Responsibility paragraph stating that the auditor is responsible for expressing an opinion on the financial statements based on the audit conducted in accordance with the SAs issued by the ICAI and explaining that the auditor has to comply with ethical requirements and plan and perform the audit for obtaining reasonable assurance whether the financial statements are free of material misstatements. The auditor should also describe what entails an audit of financial statements and state whether the audit evidence is sufficient and appropriate to provide a basis for the auditor's opinion.
- Finally, the audit opinion, which states whether in auditor's opinion (a) The financial statements present fairly, in all material respects, in accordance with (the applicable financial reporting framework) or (b) The financial statements give a true and fair view of in accordance with (the applicable financial reporting framework).

Other Reporting Responsibilities

In many cases the auditor has other reporting responsibilities in the auditor's report that are in addition to the responsibility to report on the financial statements for example as required by Section 143(3) of the Act or as required by the Companies (Auditor's Report) Order, 2016, these other reporting responsibilities are to be addressed in a separate section in the auditor's report that are required to be sub-titled 'Report on Other Legal and Regulatory Requirements', or otherwise as appropriate to the content of the section.

Non-applicability of SA 700 (Revised) to Format of Auditor's Reports prescribed under various Laws and/or Regulations

The ICAI has issued a clarification that where the format of the auditor's report is prescribed under a relevant law or the regulation thereunder and is not *per se* in line with the requirements of SA 700 (Revised), the auditor's report should be given in the format/s prescribed under the relevant law or regulation until announcement of necessary change is made by the appropriate authority.

Standard on Auditing (SA) 705 – Modifications to the Opinion in the Independent Auditor's Report:

Introduction

SA 705 deals with the auditor's responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with SA 700, the auditor concludes that a modification to the auditor's opinion on the financial statements is necessary.

It establishes three types of modifications to the opinion, namely (a) Qualified opinion; (b) Adverse opinion; and (c) Disclaimer of opinion.

Requirements of SA 705

Circumstances when a modification is required

(a) The auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or

(b) The auditor is unable to obtain sufficient appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement

Determining the Type of modification to the auditor's opinion

The decision regarding the type of modified opinion which is appropriate depends upon the nature of the matter giving rise to the modification and pervasiveness of its effects or possible effects of the matter on the financial statements as tabulated below:

Qualified opinion	Adverse opinion	Disclaimer opinion
(a) Based on evidence obtained concludes that misstatements are material, but not pervasive, or (b) Unable to obtain evidence but concludes that the possible effects on the financial statements of undetected misstatements, could be material but not pervasive	Having obtained evidence, concludes that misstatements, are both material and pervasive to the financial statements	(a) Unable to obtain evidence on which to base the opinion, and concludes that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive (b) In extremely rare circumstances involving multiple uncertainties, concludes that, notwithstanding having obtained evidence regarding each of the individual uncertainties, it is not possible to form an opinion on the financial statements due to the potential interaction of the uncertainties and their possible cumulative effect on the financial statements

Inability to Obtain Sufficient Appropriate Audit Evidence Due to a Management – Imposed Limitation

If, after accepting the engagement, the auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor considers likely to result in a qualified or disclaimer of an opinion, the auditor should request that management remove the limitation. If management refuses to remove the limitation and the auditor is unable to obtain sufficient appropriate audit evidence through alternative procedures, the auditor should:

(a) Qualify the opinion if the auditor concludes that the possible effects of undetected misstatements could be material but not pervasive or;

(b) Resign from the audit, where practicable and not prohibited by law or regulation, if auditor concludes that the possible effects could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation. If resignation from the audit before issuing the auditor's report is not practicable or possible, the auditor should disclaim an opinion on the financial statements

Form and content of the auditor's report when the opinion is modified

- When the auditor modifies the opinion on the financial statements, in addition to complying with the requirements of SA 700, the auditor needs to include a paragraph in the auditor's report that provides a description of the matter giving rise to the modification. This paragraph is placed immediately before the opinion paragraph in the auditor's report with the heading 'Basis for Qualified Opinion', 'Basis for Adverse Opinion', or 'Basis for Disclaimer of Opinion', as appropriate.

- The financial effects of the misstatements need to be quantified as far as practicable, else the auditor needs to specify that same in the report that it is not practicable to quantify the financial effects.

- If material misstatement relates to narrative disclosures, the explanation of how the disclosures are misstated needs to be specified in the basis for modification paragraph of the audit report.

- If material misstatement relates to the non-disclosure of information, the auditor needs to describe in the basis for modification paragraph the nature of the omitted information and unless prohibited by law or regulation, include the omitted disclosures if it is practicable to do so and the auditor has obtained sufficient appropriate audit evidence about the omitted information.

- If the modification results from an inability to obtain sufficient appropriate audit evidence, the auditor shall include in the basis for modification paragraph, the reasons for that inability.

- Even if the auditor has expressed an adverse opinion or disclaimed an opinion, the auditor needs to specify the reasons for any other matters of which the auditor is aware that would have required a modification to the opinion, and the effects thereof.

Opinion Paragraph

When the auditor modifies the audit opinion, the auditor shall use the heading 'Qualified Opinion', 'Adverse Opinion', or 'Disclaimer of Opinion', as appropriate, for the opinion paragraph.

A. Modified Opinion

- In case of a qualified opinion due to a material misstatement, the auditor

is required to state in the opinion paragraph that except for the effects of the matter(s) described in the Basis for Qualified Opinion paragraph that (a) The financial statements present fairly… (fair presentation framework) or (b) The financial statements have been prepared, in all material respects… (compliance framework).

- In case of an adverse opinion, the auditor is required to state in the opinion paragraph that, because of the significance of the matter(s) described in the Basis for Adverse Opinion paragraph: (a) The financial statements do not present fairly … (fair presentation framework); or (b) The financial statements have not been prepared, in all material respects, … (compliance framework).
- Amend the description of the auditor's responsibility to state that the auditor believes that the audit evidence the auditor has obtained is sufficient and appropriate to provide a basis for the auditor's modified audit opinion.

B. Disclaimer of Opinion

When the auditor disclaims an opinion due to an inability to obtain sufficient appropriate audit evidence:

i. The auditor should state in the opinion paragraph that: (a) Because of the significance of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion; and, accordingly, (b) The auditor does not express an opinion on the financial statements.

ii. Needs to amend the introductory paragraph of the auditor's report to state that the auditor was engaged to audit the financial statements, amend the description of the auditor's responsibility and the description of the scope of the audit to state only the following: "Our responsibility is to express an opinion on the financial statements based on conducting the audit in accordance with Standards on Auditing issued by the Institute of Chartered Accountants of India. Because of the matter(s) described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion."

Communication with those Charged with Governance

When the auditor expects to modify the opinion in the auditor's report, the auditor needs to communicate with those charged with governance the circumstances that led to the expected modification and the proposed wordings of the modification.

Standard on Auditing (SA) 706 – Emphasis of Matter paragraphs and Other Matter paragraphs in the Independent auditor's report

Introduction

SA 706 deals with additional communication in the auditor's report when the auditor considers it necessary to:

(a) Draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements; (Emphasis of Matter) or

(b) Draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant

to users' understanding of the audit, the auditor's responsibilities or the auditor's report (Other Matter).

Requirements of SA 706

- When the auditor include an Emphasis of Matter paragraph in the auditor's report, such a paragraph (a) shall refer only to information presented or disclosed in the financial statements, (b) shall be included in the auditor's report immediately after the Opinion paragraph under the heading "Emphasis of Matter", or other appropriate heading and (c) shall indicate that auditor's opinion is not modified in respect of the matter emphasized.
- Other Matter paragraph shall be included in the auditor's report immediately after the Opinion paragraph and any Emphasis of Matter paragraph, or elsewhere in the auditor's report if the content of the Other Matter paragraph is relevant to the Other Reporting Responsibilities section.

Communication with those Charged with Governance

If the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report, the auditor needs to communicate with those charged with governance regarding this expectation and the proposed wording of this paragraph.

In Summary

The current SAs 700, SA 705 and SA 706 arguably rank the highest in the hierarchy for an auditor as they directly relate to the end product of an auditor's work. They are crucial from an auditor's risk perspective because they lay down the principles and procedures on how an auditor forms his opinion and the manner in which he communicates the opinion. This in turn determines how the society in general or specific stakeholders will make important economic decisions. Keeping this in view, the ICAI has published a very useful Implementation Guide on SAs 700, SA 705 and SA 706. The Guide contains comprehensive guidance on the said SAs and provides answers to many of the practical issues faced by the practitioners while implementing the said SAs.

Practitioners should however be aware that Investors and other users of financial statements have increasingly called for a change in the auditor's report to enable it to be more informative – in particular, for auditors to provide more relevant information to users based on the audit that was performed, more so in light of the recent global financial crisis. To address these demands, the ICAI has issued revised drafts of the aforesaid SAs, which would be applicable for accounting periods commencing on or after April 1, 2017. By the time practitioners read this article, they would already be thinking about the new SAs – but that would be a topic for another discussion! As they say, change is the only constant in today's ever changing world!

> "Dreams are not those which comes while we are sleeping, but dreams are those when u don't sleep before fulfilling them."
>
> — *Dr. A. P. J. Abdul Kalam*

CA Hasmukh B. Dedhia

Reporting under Section 143(11) – CARO, 2016

1. General

1.1 Ministry of Corporate Affairs (MCA) issued S.O. 1228(E) on March 29, 2016 "Companies (Auditor's Report) Order, 2016" (CARO-2016) exercising its power u/s. 143(11) of the Companies Act, 2013 (the Act), in supersession of one-year-old CARO-2015. Incidentally, CARO-2015 was issued last year replacing more than a decade old CARO-2003. Thus, CARO-2015 remained effective only for a year.

1.2 The main changes brought in CARO-2015 last year compared to CARO-2003 comprised of deleting the clauses pertaining to: (1) Loans taken by the Company from parties covered u/s 189 (under old Act - S. 301);(2) Reporting by statutory auditor about scope and coverage of Internal audit; (3) Chit funds, Nidhi companies etc; (4) End use of funds raised from public issue; (5) Preferential allotment to parties covered u/s. 189 (earlier S. 301); (6) Use of short term borrowings for long term purposes and (7) Creation of Securities for secured Debentures issued.

As such, there were no additional clauses or matters contained in CARO-2015 in the last year.

1.3 Before seeing into the provisions CARO-2016 and changes compared to CARO-2015, it is worthwhile reiterating that reporting under CARO is in supplement to carrying on of audit of the Financial Statements (FS) of the Company under framework of Standards on Auditing i.e., generally accepted auditing standards; the reporting requirements under CARO do not in any way restrict or confine the scope of a statutory audit nor do they replace an audit by an investigation. The reporting requirement under CARO mandates making inquiry and following audit procedures for the matters contained therein and also making statement on each of such matters as applicable to the Company even if the result of such inquiry does not give rise to any observation and/or reportable matter.

1.4 CARO-2016 is applicable to every company, including a foreign company within meaning of Section 2(42) of the Act, but does not apply to: (i) A banking company, (ii) An insurance company, (iii) NGOs operating under section 25 of the old Act or under Section 8 of Act, (iv) One-person company u/s. 2(62) of the Act or (v) small company u/s 2(85) of Act.

1.5 The limits of turnover, share capital plus reserves and borrowings for exempting private companies from CARO have been enhanced by CARO-2016 compared to CARO-2015. Accordingly, such private limited companies which satisfy all the following conditions are exempted from the applicability of CARO-2016.

1.5.1 It is not a subsidiary or holding company of a public limited company.

1.5.2 Its paid-up capital plus reserves & surplus being not more than ` 1 crore as on date of the Balance Sheet

1.5.3 It does not have total borrowings exceeding ` 1 crore from any bank or financial institution at any point of time during the Financial year (FY).

1.5.4 Its total revenue, as disclosed as per Schedule III to the Act, including from discontinuing operations, does not exceed ` 10 crores during the FY as per its FS.

1.6 As may be noticed, the threshold of the applicability criteria has been significantly enhanced compared to earlier version of CARO which also exempted specified private companies. Moreover, if the private company is subsidiary or holding company of any public company, it is not exempted from applicability of CARO, irrespective of its capital, borrowings or total revenue. Incidentally, changes in terminology for level of operations for exempting private company from CARO are worth noting which are summarised in the table below:

In CARO-2015	In CARO-2016	Remarks
Paid up share capital & Reserves not more than Rupees Fifty Lakh	Paid up share capital and reserves and surplus not more than Rupees One crore as on Balance Sheet date	Clarification confirming the view that retained earnings are part of reserves which implies that negative balance in P&L account is to be reduced from Reserves
Does not have loan outstanding exceeding ` 25 Lakh from any Bank or FI	Does not have total borrowings exceeding ` 1 crore from any bank or FI at any point of time during the FY	Replacing term "loan o/s" by"total borrowings" makes it easier to interpret and compute the limits for applicability
Does not have turnover exceeding ` 5 crores at any point of time during the FY	Does not have a total revenue as disclosed in Schedule III to the Act, including revenue from discontinuing operations, exceeding ` 10 crore during the FY as per FS	Total revenue as recorded in the FS under Schedule III to the Act would eliminate controversies and confusion around the term "turnover"

1.7 A welcome clarification in CARO-2016 is that it shall not apply to the auditor's report on consolidated financial statements.

2. Clauses deleted in CARO-2016

In the aforesaid general background, let us first see the clauses which were part of the CARO reporting requirements in the last year, now stand deleted completely or partly.

2.1 The inquiry and reporting in relation to adequacy of internal control system pertaining to purchase of inventories and fixed assets and for sale of goods and services is deleted. This could perhaps be for the reason that reporting on Internal Financial Controls is now made mandatory.

2.2 The inquiry and reporting pertaining to transfer by the Company to Investor Education and Protection Fund is also deleted. This is clearly because rule framed u/s. 143(3)(j) also contains this item to be included in the auditor's report

2.3 The factual reporting requirement pertaining to erosion of net worth of the Company in excess of 50% and regarding cash losses of the Company during the year under

report and in immediately preceding year also stand deleted from CARO.

2.4 The inquiry and reporting pertaining to guarantee given by the Company for loans taken by others from Banks or FI and whether such act is prejudicial to the interests of the Company. This could be due to new reporting requirements about compliance of Sections 185 and 186

2.5 In relation to inventories, the reporting requirements pertaining to maintenance of proper inventory records as well as auditor's comments on procedures of physical verification followed by the management are done away with. However, questions of physical verification of inventory conducted by the management and treatment of discrepancies noticed are continued to be reported upon by the auditor.

3. New clauses/ reporting requirements added under CARO-2016

3.1 Fixed Assets: In addition to matters pertaining to maintenance of fixed assets register with full particulars thereof and physical verification, discrepancies etc., an important requirement is added to report "whether the title deeds of immovable properties are held in the name of the Company. If not, to provide details thereof". [clause 3(i)(c)].

3.1.1 It has been clarified in the Guidance Note on CARO-2016 issued by ICAI (G-note) that this reporting would have to confine only to immovable properties held as fixed assets; thus, immovable properties held as investment properties or as stock-in-trade are not to be considered for reporting under CARO. Further, immovable properties, though not defined in CARO, would mean to 'include land, benefits to arise out of land, and things attached to the earth, or permanently fastened to anything attached to the earth'. Thus, transferable development rights, plant and machinery embedded in land are not to be included for purpose of this reporting.

3.1.2 Title Deeds would mean a legal deed or documents constituting evidence of right associated with ownership of the immovable properties, which would generally constitute registered sale deed, transfer deed, conveyance document etc. The extracts obtained from registering authorities would also be considered for this purpose. In case of leasehold land and/ or buildings, duly registered lease deed or agreement would also form part of title deeds.

3.1.3 Immovable properties transferred as a result of conversion of partnership or LLP into company or under scheme of arrangement, amalgamation or demerger need to be carefully examined by the auditors, as the title deeds in such cases may be in name of erstwhile entity. In case of mortgage of properties with lenders, the confirmation from such lenders should be obtained or the same may be verified with reference to charge registration records.

3.1.4 There could be instances of title deeds lost or misplaced or for which no records are readily available with the company. In such cases, the circumventive evidences like certified copies, details of FIR filed about loss of deeds, search reports etc. need to be verified to frame the view on the matter. Needless to add, appropriate representations from the management or certificate from legal experts may also be obtained as evidence of verification.

3.1.5 Appropriate reconciliation of the evidences made available with the inventory of immovable property recorded in fixed asset register need to be obtained from the company for verification; discrepancies noticed on such reconciliation should be duly inquired into for obtaining plausible explanations. After all the above procedures, where it is noticed that title deeds are not held in the name of the company, it should be appropriately reported under this clause of CARO.

3.2 Loans granted to parties covered in Register maintained u/s. 189: Under this clause, there are some changes compared to CARO-2015

i.e., (i) Loans to LLP if covered under the said register are also be reported, (ii) To comment whether granting of loans to all such parties is prejudicial to the interests of company (iii) Steps for recovery of overdue amounts of principal or interest thereon for period exceeding 90 days to be commented upon. It is note-worthy that earlier commenting on overdue sums was required for amounts exceeding ` 1 lakh was necessary; now no such threshold of overdue amount is prescribed but overdue sum for period above 90 days is to be contained in reporting. [clause 3(iii)].

3.3 Reporting about compliance of Sections 185 and 186 of the Act: The requirements is that 'in respect of loans, investments, guarantees and security whether provisions of Sections 185 and 186 of the Act have been complied with; if not, details of non-compliance to be provided'. [clause 3(iv)].

This is new requirement and casts onerous duty on auditors.

3.3.1 Section 185, in nutshell, prohibits company from giving, directly or indirectly, loans or advances in nature of loans to Directors or to persons in whom Director is interested. It is imperative for auditor to acquaint himself with the provisions of that Section including the exceptions provided therein. It is noteworthy that Private limited companies (other than those specifically exempted *vide* circular of MCA) are also covered by clutches of Section 185.

Certified list needs to be obtained from the company of the Directors and persons in whom Directors are interested. Cross-checking of such list from register u/s. 189 as also Form MBP-1 should be carried. Dealings of company with such parties should be scrutinised in details to ascertain if there are any transactions of loans and/or guarantees given or security provided including book debts. If any such dealings are found to be attracting the provisions of Section 185, which are not covered by the exception provided in that section, suitable explanation should be sought from the management. Report of non-compliance under this section should include sums involved and amounts outstanding as at the year-end along with nature of non-compliance

3.3.2 Section 186 regulates giving of loans, making of investments by the Company. It prescribes limits up to which loans/guarantees can be given or security can be provided or securities can be acquired by a company with the authority of Board Resolution. If these limits are likely to be crossed, special resolution by members at general meeting should be passed to obtain prior approval for the transactions of loans, guarantee or providing of security or making of an investment. The section also prohibits a company from making investments through more than two layers of investment companies (this restriction is proposed to be deleted *vide* an amendment Bill, yet to be passed). The interest on the loans given must not be lesser than prevailing yield on G-sec of identical or nearly similar tenor of the loan. Again, it is imperative for auditor to acquaint himself with the provisions of this Section including the exceptions provided therein.

3.3.3 A checklist containing the conditions, restrictions, exceptions and procedures including disclosures in terms of the provisions of Section 186 should be made by the auditors. The details including evidences need to be obtained from the company as per said check-list for verification in course of audit. Such details provided by company should also be subjected to appropriate checks like cross verifying with statutory records (e.g. Form MBP-2), registers, minutes, legal opinions etc. Based on such verification and checking, for observations noticed, feed-back of the management should be obtained to determine compliance or lack thereof. The contentious issues about applicability of provisions of section to a particular transaction should be carefully scrutinised. The non-compliance u/s. 186 could be broadly divided as under:

- Investment being made through more than two layers of investment companies
- Loan or guarantee given or security provided or investments made in excess of prescribed limits without obtaining prior approval of members by special resolution
- Rate of interest charged on the loans given is lesser than prescribed
- Appropriate disclosures u/s. 186(4) not made
- Any other instance of non-compliance or default

3.3.4 The non-compliance u/s. 186, if any, noticed by the auditor should be reported in CARO in the format suggested in the G-note.

3.4 **Acceptance of Deposits:** Although, reporting requirement of CARO-2016 pertaining to compliance under this item is not different from that of CARO-2015, it is necessary to note here that provisions of Chapter V of the Act read with Rules made thereunder are lot more different and stringent compared to provisions of section 58A read with rules of old company law. To illustrate, (i) Share application money remaining as such for period exceeding sixty days is considered to be deposit under new rules (ii) Advances received from customers remaining outstanding for period exceeding one year are considered as deposit under new rules (iii) Deposits received by a private company from members (which were fully exempt earlier) may not necessarily be exempt under Chapter V of the Act. Auditors would, therefore, be well advised to carefully refer to definition of public deposit under Companies (Acceptance of Deposit) Rules, 2014 for the purpose of reporting under this clause of CARO. [clause 3(v)].

3.5 **Defaults in repayment of borrowings to Banks etc.:** This clause too more or less has remained same except that defaults in repayment to Government are also to be reported in addition to defaults in case of repayments to Banks, FI and debenture holders. Further, lender-wise details of defaults are to be contained in the report [clause 3(viii)].

3.6 **End use of moneys raised by term-loan etc.:** Reporting about use of moneys received by way of term-loans is now extended to moneys raised by way of IPO and FPO. If the end use of such funds is not made for the purpose for which same are raised, details including delays or defaults and subsequent rectifications, if any, are required to be reported under this clause of CARO-2016 [clause 3(ix)].

3.7 **Reporting about Managerial Remuneration:** The clause requires auditor to report if managerial remuneration paid or provided as payable is in accordance with requisite approvals and as per provisions of Section 197 read with Schedule V to the Act. If not, the excess amount paid or provided towards managerial remuneration and steps taken by the company for securing refund thereof is to be reported [clause 3(xi)]. This is new requirement brought in reporting under CARO for the first time.

Section 197 prescribes maximum ceiling for payment of managerial remuneration by a public limited company to its directors including managing or whole-time directors (MD or WTD). The limits under the Act have remained same as under the old Act i.e., overall cap of 11% of net profit as computed u/s. 198 of the Act by way of managerial remuneration. The remuneration to MD or manager continues to be capped at 5% and where there are more than one such whole time directors then 10% for all such whole time directors. Managerial remuneration by way of commission to non-executive directors is capped at 3% where there is no MD or WTD and 1% where there is MD or WTD. In cases where there are no profits or inadequate profits, the remuneration to MD or WTD can be paid in accordance with provisions of Schedule V. These limits do not apply to a private limited company which is not subsidiary of any public company.

The requisite approvals as required u/s. 197 read with Schedule V may include approval of the members of the company in general meeting if the remuneration paid/proposed is within

the limits, as aforesaid. If remuneration paid/proposed is not within the limits either u/s. 197 or where profits are inadequate under Schedule V, then approval of Central Government is required to be obtained by the company for payment/waiver of excess remuneration paid to managerial personnel.

3.8 **Nidhi Companies:** The clause of reporting requirement relating to Nidhi, Chit fund and such companies was omitted from CARO-2015 in last year. CARO-2016 brings the same back only partly i.e., only to the extent of reporting on maintenance by Nidhi Company net owned funds to deposits in ratio of 1:20 and whether 10% liquid, unencumbered term deposits are maintained by such companies as per requisite rules. [clause 3(xii)].

3.9 **Related Party Transactions:** The new clause brought in under CARO-2016 requires auditor to report as to 'whether all transactions with related parties are in compliance with sections 177 and 188 of the Act where applicable and whether disclosures have been made in the financial statements under applicable provisions of accounting standards' [clause 3(xiii)].

3.9.1 The clause has two distinct and separate reporting requirements i.e., (i) Compliance with Sections 177 and 188 of the Act (ii) Disclosures in FS under applicable accounting standards i.e. AS-18.

Section 177 which deals with 'Audit Committee' would apply only to such public companies whose paid up capital is ` 10 crore or more OR whose turnover is ` 100 crore or more OR whose aggregate borrowings including from debentures or deposits is ` 50 crore or more. Approval of audit committee is mandated to all transactions of company with related parties u/s. 177(4)(iv)

Section 188, under which specified transactions with related parties are to be regulated, applies to all classes of companies including private companies. The related parties with reference to the company are defined u/s. 2(76) of the Act. The nature of transactions prescribed are (i) Sale/purchase or supply of any goods or materials (ii) Selling or disposing of property of company of any kind (iii) Availing or rendering of any services (iv) Leasing of property of any kind (v) Agency arrangements for sale, purchase of goods, material, property or services (vi) Appointment of related party to any office or place of profit in the company or in subsidiary/associate (vii) Underwriting services. The thresholds for above transactions are prescribed in Rule 15 to Companies (Meeting of Board and its Powers) Rules, 2014.

The Act envisages approval of Board and/or of members for specified related party transactions crossing the threshold limits, except:

- Approval of members not required for transactions between holding company and wholly owned subsidiaries whose accounts are consolidated
- Approval of Board/Members not required if related party transactions are 'in ordinary course of the company' and at arm's length basis

3.9.2 Considering the compliance requirements and exceptions permitted, auditor should obtain necessary data pertaining to transactions entered into with related parties, the relevant minutes of the meetings, necessary corroborative evidences that transactions are in ordinary course and at arm's length so as to be able to report on the matter. Cross verifying the data with Register maintained u/s. 189 or with Form MBP 1 would be necessary. The phrase 'in ordinary course of business' is not defined in the Act/Rules. It may cover all usual transactions, customs and practices of the business of the company. Auditor needs to decide on this based on facts of each case using his professional skills and judgment. Similar issues may arise in determining whether the transactions are at arm's length or not in cases of unique services or sole supplier etc where comparable rates/prices may be difficult to get. The G-note provides some examples of transactions which may, *prima facie*, seem to be outside the company's normal business operations; detailed inquiry and scrutiny of such transactions is warranted for being able to report under this clause. Based on

audit procedures, if auditor encounters instances of non-compliance, appropriate reporting under this clause should be made giving all relevant details. Whether any non-compliance reported under this clause warrants an adverse or modified opinion of the main audit report should also be duly considered having regard to materiality and pervasiveness of the non-compliance

3.10 **Preferential allotment or Private placement of securities:** This new reporting requirement pertains to preferential allotment or private placement of securities and compliance with provisions of Section 42 of the Act; it also requires auditor to inquire upon end use of the funds so raised and report on defaults and nature of non-compliance. [clause 3(xiv)].

The compliance matters in respect of preferential allotment or private placement of shares or fully or partly convertible debentures are covered in Section 42 and rules framed thereunder. The term 'private placement' is defined to mean any offer of securities or invitation to subscribe the securities to a select group of persons by a company through private placement offer letter. Such offer letter has to be in accordance with Rule 14 of the Companies (Prospectus and Allotment of Securities) Rules, 2014. Moreover, such offer should be made in a financial year to persons not exceeding 50 or such higher number as may be prescribed, otherwise the offer shall be treated as a public offer and all the provisions of Act, Securities Contracts (Regulation) Act and SEBI provisions relating to public offer shall have to be complied with.

The Act/Rule prescribes the manner of issuance of letter of offer, time limit within which such allotment has to be made, non-usage of application money received on such letter of offer in the business of company till allotment is made and regarding refund of such money if for any reason timely allotment cannot be made

In course of audit procedures, if any non-compliance is noted or default/delay in end use of funds so raised are observed, the auditor should report the same under this clause giving all necessary particulars

3.11 **Non-cash transaction with Directors:** This new clause added in CARO-2016 relates to compliance of provisions of Section 192 of the Act pertaining to non-cash transactions, if any, entered into by the company with director(s) or persons connected with him (them) [clause 3(xv)]. The Section prohibits company from entering into any such non-cash transactions unless condition of obtaining prior approval of members through resolution in general meeting is satisfied. In other words, the clause covers transactions involving change in assets or liabilities of the company without involving 'cash' or 'cash equivalents'. In this connection, reference is invited to discussion in AS-3 "Cash Flow Statement" on 'non-cash transactions'.

Transactions carried as part of scheme of arrangements or merger/de-merger, being approved by Court, would not be regarded as non-cash transactions. Moreover, in absence of clarity or definition of the term 'person connected with the director' – the audit tests under this clause may be performed considering the definition of term 'relative' as given u/s. 2(77) of the Act and also considering the phrase 'any other person in whom the director is interested' as defined in Section 185 of the Act.

In carrying out procedures for verification under this clause, the auditor would need to evaluate whether subject matter of transaction satisfies characteristic of an asset.

The reporting under this clause is in two parts; whether there is any non-cash transaction with Director(s) or persons connected with him being the first part which can be verified from examination of agenda pack and minutes of Board meetings, Forms MBP-1, MBP-2, MBP-4, notice and minutes of general meeting etc. The findings from such verification may also be supported by appropriate representation from company management. The second part of reporting comprise of checking

compliance u/s. 192 and rules. It is obvious if first part is NIL, second part would be not applicable.

3.12 **Registration u/s. 45-IA of RBI Act, 1934:** Another new clause added in CARO-2016 requires auditor to opine as to whether the company is required to register itself u/s. 45-IA of Reserve Bank of India Act, 1934; if yes, whether such registration is obtained by the company. [clause 3(xvi)].

A company is required to register itself u/s. 45-IA of RBI Act if principal business of the company consists of financial activity. The principal business or financial activity is not clearly defined or explained in RBI Act or other literature relating thereto. As per one of the FAQ, RBI has mentioned that financial activity as principal business would mean financial assets constitute more than 50% of total assets of company and its total or gross income includes income from financial assets to the extent of 50%. This is generally referred to as 50:50 rule for registration of company as Non-Banking Finance Company (NBFC). NBFCs carry out activities similar to Banks but are restricted from some core functions of bank like accepting demand deposits etc. RBI regulates NBFCs. Several companies with main object of manufacturing or trading or service provider carry out some small financial activity. So long as such financial activity does not become its principal activity, RBI may not be interested in regulating such companies. Hence, this clause under CARO again puts an onerous duty on auditors to report about company's actual status vis-a-vis RBI Act. Audit procedures for reporting under this clause are summarised below.

3.12.1 Examine transactions of company to determine nature of activities including verifying the main object of the company.

3.12.2 Work out 50:50 rule based on the financial statements; if the said rule gives positive result, obtain representation from management about its business plan and status of registration under RBI Act.

3.12.3 Consider the net owned funds requirement under RBI guidelines for seeking registration as NBFC.

3.12.4 If despite 50:50 rule being satisfied the company does not seek registration, obtain in writing the reasons therefore.

3.12.5 Report the factual matters under this clause of CARO.

4. The way forward…..

4.1 The aforesaid write-up contains only broad overview of the changes brought about in CARO-2016. It is neither intended nor feasible to cover all the changes. Some small or fine-tuned changes in some of the clauses like (i) Disputed or undisputed statutory dues (ii) in clause pertaining to fraud reporting etc are not commented upon as these changes do not call for additional audit procedures.

4.2 There being several matters in CARO-2016 where auditors may have to frame own views on some contentious issues to be able to report on such matters unambiguously. Examples of such matters could be reporting on compliance under chapter V relating to acceptance of deposits, Sections 185/186, managerial remuneration, related party transactions, registration under Section 45-IA of RBI Act etc. In appropriate cases, it is advisable to have opinion of the independent legal expert and retain same as audit evidence.

4.3 Needless to add that any adverse remark or qualified statement in CARO would have to be supported by reasons for such adverse remarks. Further, auditors need to evaluate whether such adverse remark in CARO is significant enough to be placed in the main audit report; for this purpose provisions of SA 700/705/706 may need to be referred for guidance thereon.

CA N. Jayendran

Fraud Reporting u/s. 143(12)

A. Fraud reporting – A paradigm shift in reporting requirements

1. The auditors have been grappling with the requirements of reporting on frauds from the time of Companies (Auditors Report) Order, 2003 where the requirement of reporting of fraud noticed or reported was to be commented upon with disclosures of nature and amount involved. This was required for fraud on the Company and by the Company.

2. This was continued in CARO, 2015 and also in CARO, 2016.

3. In CARO, 2016, the reporting requirement was modified to say that whether the fraud on the Company was done by employees or officers of the Company and therefore limited the reporting requirement to only frauds committed by employees and officers of the Company.

4. The reporting requirements in CARO, 2016 emanate from the requirements of the Companies Act, 2013 which has *vide* sub-section (12) of section 143 cast an additional responsibility on the Auditors of the company to report whether the auditor during the course of performance of his duty as auditor has "reason to believe" that an offence of fraud is being or has been committed in the company by its officers or employees.

5. The reporting requirement u/s. 143(12) does not have to wait for the issuance of the Audit Report where paragraphs from CARO are reported upon. This reporting requirement requires immediate action from the Auditors to take steps to report these frauds to the Central Government.

6. The requirement to report upon the frauds u/s. 143(12) also applies to the Cost auditor and the secretarial auditor. Interestingly the same does not apply to the Internal Auditor appointed u/s . 138 although the internal auditor may be one of the first to notice or come across the occurrence of a fraud by the officers and employees of the Company as his frequency of audit is higher and his concentration is on the internal control effectiveness and non-compliances thereto.

B. What does 143(12) require from an Auditor

1. The exact text of section 143(12) is as follows:

Section 143(12)

"Notwithstanding anything contained in this section, if an auditor of a company in the course of the performance of his duties as auditor, has reason to believe that an

offence of fraud involving such amount or amounts as may be prescribed, is being or has been committed in the company by its officers or employees, the auditor shall report the matter to the Central Government within such time and in such manner as may be prescribed.

Provided that in case of a fraud involving lesser than the specified amount, the auditor shall report the matter to the Audit Committee constituted under section 177 or to the Board in other cases within such time and in such manner as may be prescribed:

Provided further that the companies, whose auditors have reported frauds under this sub-section to the Audit Committee or the Board but not reported to the Central Government, shall disclose the details about such frauds in the Board's report in such manner as may be prescribed."

2. The Companies (Audit and Auditors) Amendment Rules, 2015 issued by the Ministry of Corporate Affairs on 14th December, 2015 has amended Rule 13 of the Companies (Audit and Auditors) Rules, 2014 in which it has introduced thresholds for the purpose of reporting fraud and an additional reporting responsibility on the auditors with respect to fraud above or below the notified threshold.

3. The notified threshold as per Rule 13 is Rupees One crore or above.

4. Therefore, as per the amended Rule 13 where the auditor has "reason to believe" that a fraud has been committed or is being committed, which he has identified during the course of performance of his duty as auditor, shall report to the Board or Audit Committee as the case may be immediately but not later than 2 days of his knowledge of the fraud seeking the reply or observation within 45 days.

5. Within 15 days of receiving the reply from the management the auditor has to report the matter to the Central Government.

6. In fact, Rule 13 of the Companies (Audit and Auditors) Rules, 2014 lays down the following detailed procedures to be followed by the auditors:

   a) For fraud above Rs. One crore

      i) The auditor shall report the matter to the Audit Committee or Board within 2 days of his knowledge of the fraud seeking their reply

      ii) The Audit Committee/Board is required to reply within 45 days to the initial response of the auditor.

      iii) On receipt of such reply or observation, the auditor shall forward his report and the reply or observation of the Board/Audit Committee along with his comments on such reply to the Central Government within 15 days from the date of receipt of such reply or observation.

      iv) However, if the Audit Committee/Board does not reply to the observation of the auditor within the stipulated period of 45 days, the auditor is bound to forward his report to the Central Government along with a note containing the details of his report which was forwarded to the Board or the Audit Committee against which he has not received any response.

      v) The rules have prescribed a format for reporting which is

specified in Form ADT4. The Form ADT4 has to be e-filed by the auditor from his login ID at the MCA portal.

vi) This report shall be forwarded to the Secretary, Ministry of Corporate Affairs in a sealed envelope by Registered Post with Acknowledgement Due or by Speed Post followed by an e-mail in confirmation of the same. (The rules specify the requirement in such minute details.)

b) Where the frauds are less than Rs. one crore:

i) The auditor shall report to the Audit Committee/Board of Directors immediately but not later than 2 days of his knowledge of the fraud.

ii) He shall specify the following in his report addressed to the Audit Committee/Board of Directors

- Nature of fraud with description
- Approximate amount involved
- Parties involved

iii) Each of the aforesaid frauds reported by the auditor shall be reported upon by the Board of Directors/Audit Committee in the Board's Report which shall *inter alia* specify the following:

- Nature of fraud with description
- Approximate amount involved
- The parties involved, if remedial action not taken
- Remedial actions taken

C. Professional misconduct

1. In order that the client or the Company does not allege that the auditor has misused his position as auditor to which he has obligation to maintain secrecy and non-disclosure and the disclosure made u/s. 143(12) is in bad faith, sub-section (13) of Section 143 provides a defence to the Auditor that any disclosure made u/s. 143(12) shall not be regarded as contravention of any of the auditor's duty, if the same is done in good faith.

2. However the defence u/s. 143(13) is available only for those cases where the auditor makes the disclosure in good faith and is backed by proper professional approach in his conclusion of there being a fraud that has been committed or being committed.

D. Penalty for Non-disclosure

An auditor who does not discharge his obligation of reporting u/s. 143(12) shall be liable for penalty which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees.

E. Guidance Note by Institute of Chartered Accountants of India

The Institute of Chartered Accountants of India (ICAI) has issued a detailed Guidance Note on reporting fraud u/s. 143(12) of the Companies Act, 2013. The Guidance Note gives appropriate guidance for reporting requirements, references to auditing standards for guidance on procedures for detection and conclusion on frauds etc.

F. Definition of Fraud

Before we embark to find out the nuances of reporting under Section 143(12) of the Companies Act, 2013 read with Rule 13 of Companies (Audit and Auditors) Rules, 2014 it is important for us to know "What is Fraud".

In the 2013 Act the meaning has been considered in two specific sections.

a) Section 143(10) – Definition of fraud is as per Standards on Auditing.

As Per Standards on Auditing – SA 240 (REVISED) THE AUDITOR'S RESPONSIBILITIES RELATING TO FRAUD IN AN AUDIT OF FINANCIAL STATEMENTS, Paragraph 11(a) defines fraud as *"an intentional act by one or more individuals among management, those charged with governance, employees or third parties involving the use of deception to obtain unjust or illegal advantage"*

b) Section 447 - fraud has been separately defined as follows *"fraud in relation to affairs of a company or any body corporate, includes any act, omission, concealment of fact or abuse of position committed by any person or any other person with the connivance in any manner, with intent to deceive, to gain undue advantage from, or to injure the interests of, the company or its shareholders or its creditors or any other person, whether or not there is any wrongful gain or wrongful loss."*

This Section further explains the terms 'wrongful gain' and 'wrongful loss' to mean the gain by unlawful means of property to which the person gaining is not legally entitled; and the loss by unlawful means of property to which the person losing is legally entitled, respectively.

c) *Fraud has also been defined by various other regulators/statutes.*

i) The Insurance Fraud Monitoring Framework of the IRDA defines fraud in insurance as *'an act or omission intended to gain dishonest or unlawful advantage for a party committing the fraud or for other related parties.'*

ii) Reserve Bank of India, *per se*, has not defined the term 'fraud' in its guidelines on frauds. A definition of fraud was, however, suggested in the context of electronic banking in the Report of RBI Working Group on Information Security, Electronic Banking, Technology Risk Management and Cyber Frauds, which reads as, *'a deliberate act of omission or commission by any person, carried out in the course of a banking transaction or in the books of account maintained manually or under computer system in banks, resulting into wrongful gain to any person for a temporary period or otherwise, with or without any monetary loss to the bank'.*

iii) *Fraud, under Section 17 of the Indian Contract Act, 1872, includes any of the following acts committed by a party to a contract, or with his connivance, or by his agents, with intent to deceive another party thereto or his agent, or to induce him to enter into the contract:*

- *The suggestion as a fact, of that which is not true, by one who does not believe it to be true;*
- *The active concealment of a fact by one having knowledge or belief of the fact;*
- *A promise made without any intention of performing it;*
- *Any other act fitted to deceive;*
- *Any such act or omission as the law specially declares to be fraudulent.*

G. So what does an auditor need to do

1. The reading of section 143(12) with Rule 13 of the Companies (Audit and Auditors) Rules, 2014 envisages the auditor to be

the whistle blower if in the course of performing his duty as auditor, he has reason to believe about a fraud that is committed or being committed.

2. Where the auditor has become aware of fraud which has already been identified by the management either through its internal process or through the whistle blower mechanism and the auditor is not the first person to be aware of the fraud or identify the fraud, he cannot be said to be the person who has "reason to believe" that an offence involving fraud is being or has been committed which he has identified during the course of his performance of his duty as an auditor. *In such cases the auditor is not required to report the same u/s. 143(12) since he is not per se the person who has identified the fraud.*

3. However, where the fraud involves the amount in excess of Rs. One crore which has been reported by a person other than the auditor and the auditor is not satisfied with the steps taken by the management then, he should state the reasons for such dissatisfaction in writing and request the management and those charged with governance to perform additional procedures to enable the auditor to satisfy himself that the matter has been appropriately addressed.

4. If the management fails to respond to such request within 45 days then the auditor should evaluate his reporting obligation u/s. 143(12) whether he should report the matter to the Central Government in accordance with Rule 13 of the Companies (Audit and Auditors Amendment) Rules, 2014.

5. As per the language of section 143(12), the auditor should report if he has "reason to believe". The words "reason to believe" cannot be based merely on suspicion but must be backed with sufficient information or convincing evidence to advance beyond suspicion that it is possible to demonstrate that someone is or has committed a fraud.

6. Merely identification of a fraud risk cannot be reason to believe that a fraud has been committed or exists.

7. The provisions of section 143(12) apply only to fraud by employees and do not apply to fraud by vendors, third party service providers, etc. Similarly the fraud by the employee or officer on the Company gets covered and fraud on say a vendor or third party service provider by an employee or officer is outside the scope of reporting u/s. 143(12).

8. Reporting u/s. 143(12) is required to be done in the case of a Company even if the fraud reporting is required to be done to some other regulator or under any other statute. For e.g., if there is a fraud in a bank and reporting of the fraud has been done to RBI by auditor, the reporting u/s. 143(12) is still required to be done to the MCA where the bank is a company under Companies Act, 2013.

H. Non-attest and attest functions other than Statutory Auditor

1. The auditor while rendering attest functions which are carried out under a different statute e.g. limited review, tax audit, other certification, may detect a fraud during the performance of such attest functions.

2. The question, which would arise, is whether the reporting responsibility u/s. 143(12) would apply to such detection.

3. The guidance note issued by the ICAI clarifies that where the auditor proposes to use the information, which he has gathered during the course of rendering the aforesaid functions, in discharge of his functions as a statutory auditor, reporting responsibility u/s. 143(12) would be applicable.

4. It is therefore advisable that the auditor reports such cases u/s. 143(12) unless the offences noticed in the course of attest

functions are not at all connected with his functions as statutory auditor of the company. The position would be the same while performing of non-attest functions.

I. Audit of Consolidated Accounts

1. Where an auditor detects a fraud while carrying out audit of consolidated financial statements he is not required to report on such frauds if these frauds arise out of accounts of the components, unless they have been committed against the parent company by the employees or officers of the parent company. The guidance note explains situations where the reporting responsibility of the auditor u/s. 143(12) would arise and where it would not arise.
2. Accordingly, the auditor of the parent company is not required to report on frauds under section 143(12) if they are not being or have not been committed in the parent company by the officers or employees of the parent company but relate to frauds in:
   a. A component that is an Indian company, since the auditor of that Indian company is required to report on suspected offence involving frauds under section 143 (12) in respect of such company; and
   b. A foreign corporate component or a component that is not a company since the component auditors' of such components are not covered under section 143(12).

J. Auditor Report under Section 143(12) in case of corruption, bribery, money laundering and Non-compliance with other Laws and Regulations

1. The auditors responsibility with respect to situations where there are corruption, bribery, money laundering and other intentional non-compliance with other laws and regulations is that the auditor should consider whether such acts have been carried out by officers or employees of the company for the purpose of reporting and also take into account the requirements of SA-250, particularly paragraph 28 of SA-250 read with paragraphs A19 and A20.
2. For example, if the auditor comes to know that the company has filed a fraudulent return of income to evade income tax, he may have to report this fraud under Section 143(12) irrespective of whether adequate provision has been made in the books of accounts or not.
3. It may be noted that the proviso to Section 147(2) in the context of punishment to auditors for contravention with the provisions, *inter alia*, of section 143 of the 2013 Act, states, "if an auditor has contravened such provisions knowingly or wilfully with the intention to deceive the company or its shareholders or creditors or tax authorities, he shall be punishable with imprisonment for a term which may extend to one year and with fine which shall not be less than one lakh rupees but which may extend to twenty-five lakh rupees."
4. Therefore such situations also need to be reported with diligence and utmost scepticism backed with adequate and convincing evidence.

K. SA-240 "The Auditor's responsibilities relating to fraud in an Audit of Financial Statements".

1. An auditor is required to carry out the following procedures as specified in SA 240:
   a. To identify and assess the risks of material misstatement in the financial statements due to fraud;

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

c. To respond appropriately to identified or suspected fraud.

2. SA 240 provides examples of fraud risk factors that may be faced by auditors in a broad range of situations, specifically relating to the two types of frauds relevant to the auditor's consideration, i.e., fraudulent financial reporting and misappropriation of assets.

3. The auditor will have to design the audit procedures at an entity depending upon the identified fraud risk factors for possible mitigation of the assessed risk of material misstatement arising out of fraud.

4. SA 240 provides examples of possible audit procedures to address the assessed risk of material misstatement due to fraud.

5. The stages of identification of Fraud are broadly bucketed in four as can be obtained during the course of the audit.

   a. Speculation.

   b. Suspicion.

   c. Reason to Believe.

   d. Knowledge

6. Speculation or hearsay is generally the first stage when the auditor happens to hear some unconfirmed news, gossip, rumour, etc. about possible kickbacks, money laundering, tax avoidance, falsified supporting etc. Speculation cannot be a basis for fraud reporting under any circumstance.

7. However 'suspicion' is a state of mind more definite than speculation, but falls short of knowledge based on evidence. There is a strong scepticism about something not being right but evidence to prove the same is lacking or still to be received or confirmed. However even this feeling or opinion must be based on some evidence, even if that evidence is tentative. Suspicion is a form of opinion but without sufficient evidence. Suspicion is therefore the first definite stage of fraud identification and an auditor would need to take further steps to conclude on his suspicion with more definitive evidence. It is not necessary however that the suspicion must result in fraud identification and therefore the auditor must use his best judgment dispassionately to conclude.

8. The "reason to believe" is a stage where the auditor has adequate evidence that helps to form his opinion that a fraud is being committed or has been committed. This is more than a mere suspicion and is generally the next stage to suspicion where the auditor has acquired corroborative evidence to support his suspicion and has resulted in his reason to believe. Some of the examples would be falsified supporting where there are corrections made in a different hand and different ink to get benefit, resistance from management for certain disclosures without offering adequate business reasons, discrepancy in books and physical stocks, differences in cash balances on physical verification etc.

9. The last of the stage or bucket is knowledge. "Knowledge" indicates "reason to believe" with more persuasive evidence based on further procedures and evidences and possible admission by the perpetrators.

10. At the stage where the auditor has "knowledge" of fraud backed with adequate supporting and documentation, his responsibility u/s 143(12) gets triggered and as a first step he must intimate the audit committee / board of directors within two days of his acquiring the knowledge.

11. There can however be a situation where the Auditor may stumble upon a fraud without going through the earlier buckets of suspicion or reason to believe and therefore the knowledge need not necessarily preceded by the earlier stages.

L. Form of reporting ADT4

1. Apart from the requirements of the name of the company and auditors details, the ADT4 requires the following additional information, which the auditor needs to collate and have ready with him for the purpose of uploading his report in Form ADT4.

   i) Address of the office or location where the suspected offence is believed to have been or is being committed.

   ii) Full details of the suspected offence involving fraud. For this purpose the auditor is required to elaborate the complete basis of his "reason to believe" that the fraud has been or is being committed.

   iii) He is also required to attach documentary proof in support of the matters, which are being elaborated.

   iv) The names of the officers or employees who are being suspected to be involved in the commission of the offence with details of his designation (DIN if director) and PAN.

   v) For this purpose the auditor may need to obtain the details of his PAN from the HR Department which the auditor must collect during his process of conclusion of reporting requirements u/s. 143(12).

   vi) The auditor must also detail the basis on which the fraud is suspected.

   vii) Period during which the suspected fraud has occurred. Here the auditor must detail the period covered by him which led to his reason to believe that the fraud has been committed or being committed and the periods for which the auditor feels that the frauds may have been committed.

   viii) Date of sending preliminary report to the board or audit committee as required by Rule 13(2)(a).

   ix) Date when reply is received from the board or audit committee and the copy of such report must be scanned and attached along with the form.

   x) The auditor is required to mention whether he is satisfied with the reply of the board or audit committee.

   xi) Estimated amount involved in the suspected fraud.

   xii) Details of steps taken, if any, by the company in this regard.

2. The above reporting requirements are to be attached and uploaded and therefore the auditor must have all the relevant documents scanned and ready with him before he can sit down to upload the report in Form ADT4.

To conclude, the reporting requirement u/s. 143(12) is more elaborate and is time bound as compared to the reporting requirements under CARO (so far as it relates to frauds on the Company). Here the auditors' documentation and his basis for reaching the conclusion that he has "Reason to Believe" has to be properly substantiated. Unlike the CARO reporting the auditor here has to report on only those issues where he is first identifier of the fraud perpetrated by the employee or officer.

CA Jayesh Gandhi

Internal Financial Controls over Financial Reporting – Auditors Responsibility

Preamble

Over the years and with the introduction of The Companies Act, 2013 (The Act), responsibility of the Statutory Auditors (also called as Independent Auditors) has increased substantially. Now, as per section, 143(3) of the Act, auditors need to report in their auditors' report whether the Company has adequate internal financial controls system and its effectiveness. It is difficult to argue that in the past such assessment is not carried out by the auditors to conclude and issue audit opinion. For any medium or large size company, audit is conducted with Risk Based Approach. In this approach assessment is made of internal control system and its effectiveness to decide on audit procedures to be adopted. In following paras, I have attempted to bring different aspects of the Internal Financial Control and how it has to be dealt with for reporting by auditors.

Concept

To bring the reporting in line with the global reporting framework, the need for reporting on Internal Financial Control over Financial Reporting (IFC) was felt necessary in India as well. In many countries Sarbanes Oxley Act requires certification on IFC by the management and auditors. Similar concept is introduced in India through Section 143(3)(i) of the Act, which requires auditors' report to state whether the company has adequate internal financial controls system in place and the operating effectiveness of such controls. Also, the management of the company is required to confirm and comment on IFC in their Director's responsibility statement.

The reporting on IFC by Statutory auditors is applicable to all companies including small companies. For smaller companies, it may be difficult to implement and keep required documentation. This aspect has been dealt separately in this journal. Furthermore, the reporting on IFC is required for both, standalone and consolidated financial statements. Reporting on IFC applies to annual financial statements and does not apply to interim financial reporting.

Statutory Auditor has to report whether the company has adequate internal control systems in place and whether they were operating effectively as at the balance sheet date. That doesn't mean the testing of the controls is to be done only on balance sheet date. The auditors should test the controls during the financial year under audit and update changes, if any up to the balance sheet date.

The concept of internal control was already in existence in the form of SA 315, which defines internal control as "the process designed, implemented and maintained by those charged with governance, management and other

personnel to provide reasonable assurance about the achievement of an entity's objectives with regard to (i) reliability of financial reporting, (ii) effectiveness and efficiency of operations, (iii) safeguarding of assets, and (iv) compliance with applicable laws and regulations. The reporting on internal control for specific areas is required to be commented upon by auditors in CARO as well."

Components of Internal Control

The below are five components of Internal Control which operates at the entity level and transaction level.

(I) **Control environment:** It includes 1) Integrity, ethical values and behaviour of key executives; 2) Management's commitment to competence; 3) Participation in governance and oversight by those charged with governance; 4) Organisational structure and assignment of authority and responsibility 5) Management's control consciousness and operating style, 6) HR policies and practices.

The auditor should assess whether management's philosophy and operating style support effective IFC.

(II) **Risk Assessment:** Auditor should obtain understanding of whether the entity has a process for:

- Identifying business risks relevant to financial reporting
- Estimating the significance of the risks
- Assessing the likelihood of their occurrence
- Determining actions to address those risks

(III) **Monitoring:** Monitoring is a process of:

- Assessing the effectiveness of the performance of internal controls over time
- Determining whether controls are operating as intended
- Determining that internal control systems are modified as appropriate for changes in condition

Inquire with the management about the sources of information it uses in monitoring activities and how management is satisfied about the integrity of that information.

(IV) **Information and Communication:** Obtain an understanding of the information system, including the related business processes, relevant to financial reporting. Further understand how the entity communicates financial reporting roles and responsibilities and any matters that are significant to financial reporting, including:

- Communications between management and those charged with governance
- External communications, such as those with regulatory authorities

(V) **Control Activities:** Control activities relevant to an audit may be categorised as policies and procedures relating to:

- Performance reviews
- Information processing
- Physical controls -- physical security for adequate safeguard of assets and records including access to computer programmes and data files.
- Segregation of duties

To obtain an understanding of the components of internal control at the entity level and related elements, the auditor needs to:

- Inquire of management and of others within the entity who, in auditor's

judgment, may have information that is likely to help in identifying risks of material misstatement

- Observe processes and controls in operation
- Inspect documents and reports

Methodology

Generally, there is no different audit process or approach adopted for reporting on IFC by Statutory auditors. The risk based approach followed covers the audit methodology which helps in expressing an opinion on true and fair view of the financial statements as well as opining on the adequacy and effectiveness of the entity's system of IFC.

Auditors should design procedures for testing of controls to accomplish the objectives of both audits simultaneously. The effectiveness of the controls in place will decide the work to be performed through substantive procedures.

While conducting the audit through risk based approach, the concentration is on whether the control is in place. To evaluate the existence and operating effectives of the controls, following procedure is generally followed:

Planning is very important in audit. The planning process for IFC audit will cover the following work steps:

- Identify significant account balances/ disclosure Items
- Identify & understand significant flows of transactions
- Identify risk of material misstatements
- Identify controls which address risk of material misstatements

Once the above activities are carried out, the design assessment is started wherein the below key work steps should be covered:

- Start with Entity Level Controls (ELC) and IT General controls
  – Focus on segregation of duties + Functional MIS
  – Review strength of IT general controls
- Prepare documentation templates – Flowcharts / Narratives
- Document process and application controls
  – Identify what can go wrong (WCGW) - Risks
  – Prepare Risk & Control matrix with control description, owner, frequency, control evidence, etc.
  – Perform & document walkthroughs
  – Update process maps with risks, controls references
  – Identify controls into Manual, Automated, IT dependent, Preventive/ Detective
- Identify design gaps
- Benchmark IFC controls – consolidate, remove redundancy

Generally 'Top-down' approach is followed in identifying and understanding the controls that are relevant to the audit.

Benefits from leveraging effective ELC's

- Reduce the extent of reliance on transaction level controls
- Better define and communicate the expectations of management across the organisation
- Through leveraging on experienced personnel, increase the effectiveness of internal controls
- Reduce redundancy in controls performed across the organisation at different levels

Nature of ELC testing

- Inquiry AND
- Observation AND
- Inspection

IT General Controls

Generally large companies have complex IT system and it is important to have IT General Control (ITGC) evaluation and its effectiveness. The ITGC protect data integrity and are a significant component of an organisation's IFC.

ITGCs include controls in the three areas -

- Access security,
- System change control, and
- Data centre and network operations

IT General Controls are often considered as indirect entity-level controls.

Importance of ITGCs

- Improves the consistency of control operation (i.e., automated processes vs. manual)
- Improves the security (confidentiality, integrity and availability) of corporate information
- Reduces the extent of testing and reliance on manual transaction-level controls
- Improves reliability of manual controls dependent on IT information

If the response to the ITGC evaluation is ineffective, then the following actions should be taken to respond to the ineffective ITGC's

- Identify and test other ITGCs (Compensating) that sufficiently reduce the risk within the IT process associated with the ineffective ITGC to an acceptable level
- Perform IT-substantive testing procedures to obtain reasonable assurance that the risk within the IT process associated with the ineffective ITGC was not exploited
- Identify and test controls within the significant class of transactions that sufficiently reduce the risk within the IT process associated with the ineffective ITGC to an acceptable level
- Directly test the application and ITDM controls and the underlying data used in these controls throughout the period of reliance
- Modify the nature, timing and extent of substantive procedures

If control exceptions are identified:

- Make specific inquiries and investigate the nature and cause of the exception
- Determine whether the exception is systematic or random.
- Evaluate the effect of the exceptions on planned audit procedures and other areas of the audit

If ITGCs are not effective, then it is generally necessary to test the automated controls at or near the balance-sheet date in support of the opinion on internal financial controls.

For the IFC opinion (assuming ITGC deficiencies are not remediated), auditor needs to evaluate the effect of the ITGC deficiency on a control by control basis.

- Some controls may be unaffected
- For some controls one may identify compensating controls (e.g., SCOT controls)
- Remaining control deficiency to be accumulated for further analysis

Following is the audit approach followed in less complex IT environment

- Identify IT related risks by understanding the software being used

- Understand how software is installed and used by the company
- Identify the controls that address, the identified IT related risks

Information Produced by the Entity

There is one more important concept to be kept in mind while evaluating the IFC is Information Produced by the Entity (IPE). IPE are data generated or processed through an IT application and/or end user computing solution, be it in electronic or printed form, used to support audit procedures. Specifically, it includes:

- Data and reports used by management in the performance of controls
- Data and reports used in our substantive procedures
- Other data and reports provided by the entity

Some common IPEs are system-generated ageing reports, expense amortisation reports, fixed asset system-generated reports used to calculate depreciation/amortization etc.

When using IPE as audit evidence, the auditor should evaluate whether the information is sufficient and appropriate for purposes of the audit by performing procedures to:

- Test the accuracy and completeness of the information or test the controls over the accuracy and completeness of that information; and
- Evaluate whether the information is sufficiently precise and detailed for purposes of the audit.

Understanding of Process

Once ITGC effectiveness is checked, it is important to understand the process designed by the management for each significant class of transactions (SCOT). Generally the design of process is documented by the management by way of narratives or standard operating procedures (SOPs). Auditor shall understand the design of each process and identify what can go wrong (WCGM) i.e., what risks are involved. For each such risk, which controls are exercised is documented in Risk & Control Matrix. If this matrix is available with the management, auditor needs to understand any gaps and additional controls required to mitigate the risks. Risk & Control matrix can be updated for additional controls.

- Significant class of transactions (SCOT) is a class of transactions
  - That materially affects a significant account and its relevant assertion.
  - Includes significant routine, non-routine and estimation transactions from initiation, recording, processing, correcting as necessary and reporting to the financial statements.
- Understand the following elements of the critical path of SCOTs
  - Major input and output sources
  - Relevant transaction data and master data, documentation and records
  - Significant processing procedures, including how IT applications support the processing
  - The entity's policies and procedures related to authorisation, segregation of duties, safeguarding of assets, monitoring of processes and information processing

In order to understand the above we carry out a walkthrough for each of the SCOT.

Testing of Operating Effectiveness

Walkthroughs ordinarily are sufficient to evaluate design effectiveness of the controls. Once this is done, test of controls (TOC) is

carried out. While testing the controls, the nature, timing and extent of TOCs are to be kept in mind.

- Nature of tests of controls:
  - Inquiry,
  - Observation,
  - Inspection of relevant documentation, and
  - Reperformance of a control.
- Timing of tests of controls is influenced by:
  - The risk associated with the control
  - The frequency with which specific controls operate and specific policies are applied.
- Extent of tests of controls is determined by:
  - The frequency of the performance of the control by the entity during the audit period.
  - The relevance and reliability of the audit evidence to be obtained
  - The extent to which audit evidence is obtained from tests of other controls related to the assertion
  - The nature of the control, including, in particular, whether it is a manual control or an automated control
  - For an automated control, the effectiveness of relevant general IT controls
  - Higher risk associated with the control
  - The expected rate of deviation from a control

While performing the operating effectiveness testing of controls, the main thing to be kept in mind is the sample size to be tested. Sample items should be selected in such a way that the sample can be expected to be representative of the population. One should identify the sample size to get comfort on the effectiveness of the control and one has to also apply professional judgment to determine the sample size after taking into account the guidance note issued by ICAI.

Some important aspects for sampling:

- The sample selected for walkthrough of controls may be included as part of sample size.
- Manual controls are subject to more extensive testing than automated controls.
- The sample sizes for ITGCs are the same as for manual and application controls, depending on the manual and automated aspects of ITGCs.

One can rely on the testing done in interim period, but since reporting is done for full financial period, further or additional testing is required for the samples from the subsequent period as well.

Some companies, even outsource some of their important processes or SCOT to a service organisation. In such cases, an auditor should ensure that a service organisation has been through an in-depth examination of their control objectives and control activities, which often include controls over information technology and related processes. In this connection auditor should conduct an independent understanding on the controls in place and their operating effectiveness. If the client has already got the relevant IFC work of their operations carried out by an independent auditor, one can rely on the reports issued by the independent auditor while forming an opinion on the IFC. One needs to understand the coverage done by the independent auditor in their report and if required additional work should be performed.

Once the testing is done, we should assess the findings of the testing and conclude on the operating effectiveness before forming an opinion on the IFC.

Control Deficiencies

Reporting is the conclusion of work performed by the auditors. It is duty of the auditors to draw proper conclusion on testing conducted and reports verified in the course of its duty. To conclude the reporting in respect of Internal Financial Controls, audit team needs to first identify control deficiencies noticed during the course of audit. It should be accumulated at one place so that its effect can be identified for individual item assertion and also for financial statements as a whole. In the context of IFC, deficiency exists when the design or operation of a control does not allow management to prevent or detect and correct misstatements on a timely basis, so that misstatements do not percolate to the financial statements of an entity. It is important to note that besides financial numbers, misstatements can also occur in various disclosures in the financial statements which are required as per the applicable Accounting Standards or statute or otherwise.

Control deficiencies to be identified are two viz.: Design deficiency and Operation Deficiency

- Design deficiency means a control necessary to meet the control objective is either missing or an existing control is not properly designed.
- Operation deficiency means a properly designed control is not operating as per design, or when the person performing the control does not possess the necessary authority, competence or objectivity to perform the control effectively. It means that control function should be assigned to responsible and knowledgeable person.

Let us take an illustration:

If a company has an accounting software which is not capable of generating accurate age-wise analysis of items in inventory, it is considered as design deficiency. It is possible that age-wise report of inventory items is generated, however it does not eliminate inter-department transfers and therefore it is not accurate. This also should be treated as Design Deficiency.

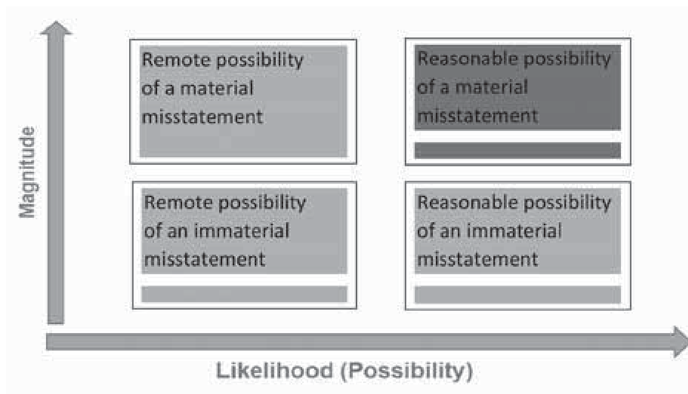
Take a case, where the changes can be made manually to the age-wise report and person in charge of control is not reconciling total inventory figure in the report with the amount as per the trial balance, it is operation deficiency. In this case, there may be a proper design but operation controls are not effective.

Exceptions noticed during the course of audit needs to be evaluated whether it is systematic or not and if not systematic whether rate of occurrence is acceptable or not. If exceptions are systemic or rate of occurrence are not acceptable it needs to be concluded as Control Deficiency. Documenting exceptions and how it is concluded is important. It should, therefore, be properly reflected in work papers of an auditor.

Once Control Deficiencies are identified, next step is to conclude whether they are significant deficiencies or a material weakness. There has to be assessment of deficiencies using professional judgment. Auditor needs to evaluate severity of each deficiency considering various quantitative factors (amount of total transactions exposed and the volume of activity in the class of transactions) and qualitative factors.

Significant Deficiency is a deficiency or combination of deficiencies that is less severe than a material weakness, yet important enough to merit attention of the audit committee or those charged with Governance (TCWG).

Material weakness is a deficiency or combination of deficiencies, such that there is a reasonable possibility that a material misstatement of the entity's annual financial statements (whether of an account balance or disclosure) will not be prevented or detected on a timely basis. It is not necessary that material misstatement percolates into financial statements. Even if there is a reasonable possibility of such occurrence it needs to be treated as material weakness. Following chart shows how to evaluate Control Deficiencies.



Reporting

(a) As per section 143(3) of the Act, Auditor's Report shall include opinion on whether the Company has adequate internal financial control system in place and the operating effectiveness of such controls as on the balance sheet date.

(b) It is preferable, but not necessary, to issue separate annexure to the main auditor's report. In other words, the opinion on IFC can form part of the main report. In case it is given as a part of annexure, reference of the same should be given in the main report. Annexure should also be signed on the date of signing of the main report.

(c) Format of separate report shall include:

- Introduction: Management and auditor's responsibility
- Scope: conducted in accordance with the ICAI Guidance Note and standards on Auditing, that audit is to obtain reasonable assurance and the audit provides a reasonable basis for the opinion
- Inherent Limitations: That it may not prevent or detect misstatements and evaluation may not hold good for future periods
- Opinion: Adequacy of IFC design and its operating effectiveness on the balance sheet date

(d) Following are common types of reporting:

- Unqualified opinion: For no material weakness
- Qualified opinion: The effects / possible effects of the material weakness in IFC are material but is not pervasive to the FS
- Adverse Opinion: The effects / possible effects of the material weakness in IFC are both material and pervasive to the FS. Such a situation is most likely to adversely impact opinion on the FS for any medium or large size company

  If sufficient substantive procedures are performed by auditors to respond to the identified material weakness, auditors may express an unqualified opinion on the FS, but the onus will be entirely on the auditors in such a case
- Scope Limitations: In case there are restrictions imposed by the circumstances or by the management.

Conclusion

Internal Financial Control assessment is not a new requirement. This assessment is required for any audit under Risk based approach. However, proper efforts are required, both from management and auditors, to document, design and test the operative effectiveness of IFC. The risks for an auditor to some extent have increased, as it has to make specific assertion. Auditors need to be careful in its conclusion when one of the report is qualified. Only time will tell, how opinion on IFC increases the risk for auditor, in case of subsequent detection of material misstatement in the FS or fraud in the company.

CA Paresh Clerk

Internal Financial Controls over Financial Reporting – SME perspective

Background

Small and Medium Enterprises ("SMEs") play an important role in the economic and social development of a country by contributing 45% of the industrial output, 40% of exports, 42 million in employment, create one million jobs every year and produces more than 8,000 quality products for the Indian and international markets.[1] Yet, SMEs face problems like inadequate and timely banking finance, non-availability of suitable technology, ineffective marketing and non-availability of skilled manpower.

The term SME is defined under the Micro, Small and Medium Enterprises Development Act, 2006 based on the size of investment in plant and machinery; however, for the purpose of this article, the term SME is used for smaller companies having the following attributes:

- Concentration of ownership and management with few individuals
- Few lines of business and/or products and less complex opeations/transactions
- Few levels of management with responsibility for a wide span of control
- Few personnel with a wide range of duties
- Simple and centralised manner of account and record keeping and not so sophisticated Information Technology (IT) system and infrastructure
- Few internal controls

There is not doubt that even SMEs need to function smoothly, effectively and in an environment that is free from risks of frauds and errors. However, since SMEs often do not have sufficient or effective internal controls, and could be vulnerable to fraud, employee embezzlement and the like, there is a need to emphasise the role of internal control in SMEs. Owner-directors and/or senior management should demonstrate a thorough understanding of the concept and need of internal control.

Statutory provisions in a nutshell

Section 134(5)(e) of the Companies Act, 2013 ("the Act") through the Directors' Responsibility Statement, requires all listed companies to state about establishing adequate IFC and asserting operating effectiveness of such controls. However, Rule 8(5)(viii) of the Companies (Accounts) Rules, 2014 requires the Board of Directors' report of all companies to state the details in respect of adequacy of Internal Financial Controls over Financial Reporting ("IFC over FR"). Section 143(3) of the Act applies to the statutory auditors of all companies. Thus, the auditors of even unlisted companies

1 Source: www.smechamberofindia.com

(whether public or private) are required to report on the adequacy and operating effectiveness of IFC over FR. For statutory auditors, reporting on IFC over FR was voluntary for the financial year ("FY") 2014-15, however, with effect from FY 2015-16, it is mandatory. It is also true that the primary responsibility for establishing adequate IFC over FR and ensuring that the same are operating effectively rests with the management in case of all companies.

Requirements for IFC over FR

Broadly, IFC over FR should have –

- Vision and Mission Statement
  - Outlines the very purpose of the business and what it strives to achieve in the long-run.
  - Along with the long-run objectives, the statement also points out the code of ethics to be followed.
- Formal procedures and discipline in place for each process:
  - Key policies are defined; defines and highlights the harmonised flow of procedures for various processes.
- Standard Operating Procedures ("SOPs")
  - A detailed documentation of each process that takes place in an enterprise.
  - Explanation of processes is usually provided in the text form and additionally assisted by way of flowcharts. SOP would generally answer :
    - What triggers the process?
    - Who all are involved in the process? How duties of persons involved are segregated ?
    - How the procedures are performed?
    - What all are the documents that are involved?
- Process Flow Diagrams
  - Process Flow Diagrams are diagrammatic representations of SOPs. These diagrams clearly show the flow of documents, persons involved, the controls in place and the Information Produced by the Entity (IPE).
    - IPE is in the form of various reports which are manually generated and/or through the system. IPE may be used by the management for analysis, etc. and used by the auditors as a source of evidence of testing. Examples of IPE – Debtors ageing report, Sales analysis, Ratio a nalysis and similar other statements/ spreadsheet workings.
  - Process flow diagrams depict the process to initiate, authorise, record and report transactions; the points at which misstatements could occur; control activities which would prevent or detect such misstatements.
- Risk Control Matrix ("RCM")
  - Lists down the possible Risks of Material Misstatement (ROMM) along with their assertions and stating the controls in place for each possible and existing ROMM.
  - Further, RCM incorporates frequency of controls performed, whether the controls are automated or not, and most importantly, the design and operating effectiveness of the controls.
- Authority Signature Matrix ("ASM") (also referred to as Authority Matrix):

  - Draws out the authorisation at each level for every process that takes place.
- Responsibility Allocation Matrix ("RAM") (also referred to as Responsibility Matrix):
  - It lays down responsibility chart and clearly defines the roles of every person at each level in a department and specifies what is expected of him or her.
  - RAM brings out segregation of duties.
  - It also becomes easy for anyone to understand the flow of responsibility in an enterprise.

ASM and RAM, both, may form part of SOPs.

- System audit:
  - Information systems are not just the computer systems but other associated systems including performance reviews, distribution systems and manufacturing systems.
  - To ensure that all systems are in place, conduct of a system audit is necessary.
- Internal audit:
  - Though having an internal audit is not mandatory for every company, however, it is preferred that companies have it, since majority of the internal control design weaknesses could be highlighted and improvements thereto would be suggested.

Challenges for SMEs

Though IFC over FR is beneficial even for an SME, it faces an array of challenges owing to its nature, structure and size. Some of the main challenges are:

- Involvement of Owner-directors and/or senior management and Management override
  - ➢ Generally, owner-directors and/or senior management is extensively involved in the day-to-day activities and perform duties that are important for effective controls. At times, they are the only authorised signatories for most processes. Such involvement provides additional opportunities to the management to override controls or intentionally misstate the financial statements. Thus, SMEs are prone to the risk of management override.
- Lack of Formal Procedure and Discipline:
  - ➢ SMEs operate as per style and ideas of Owner-directors and/or senior management and hence, often lack formal procedures and discipline and such procedures keep changing as a result of which these are not documented by way of SOPs or the like.
- Lack of Human Resources and management skill:
  - ➢ Since the number of employees are few, many times the roles and responsibilities are not clearly defined and one person handles multiple tasks. Also, authorities are often not clearly defined. This allows any person to be in a position to both perpetrate and conceal errors or fraud in the normal course of the person's duties. Thus, there is a limit to segregate duties and therefore, to have maker-checker is not possible. In addition, it may not be possible in recruiting and retaining personnel with financial reporting competencies. This in itself is a risk of material misstatement.

- Aversion to Audits:
  - The management has aversion to audits, such as System Audit or Internal Audit, not only for the cost involved, but also due to the misconception that everything is under control of owner-directors and the enterprise requires no such audit.
- Other challenges would be limited capital, lack of IT support and lack of proper documentation.

Measures for Implementation

Despite challenges, SMEs could design simple yet an adequate IFC over FR. For this purpose, some significant measures are specified hereafter:

- Process Flow Diagrams:
  - Detailed SOPs may be difficult to prepare and maintain, however, basic process flow diagrams should suffice since they broadly cover the entire process and are visually easy to understand. In fact, noting down broad steps involved in a process would also be sufficient.

  A sample (but simple) process flow diagram is given in Annexure A. Similarly, process flow diagrams should be prepared for the other areas such as Sales, Expenses, Bank Payments/Receipts, Cash Payments/Receipts, Fixed Assets, Taxation, etc.
- Checklists:
  - It is a set of basic questions that need to be answered when each process is performed. These questions should cover each procedure that takes place within a process. Answering these questions (alongwith other IPEs) would be sufficient to evaluate whether the controls are in place and identify gaps in the design.
  - Answers in a checklist would also enable anyone to ascertain -
    - Which controls are relevant and adequate, which either are to be modified, or eliminated or where risks involved could be minimised?
    - How well are the financial aspects of the business managed?
    - Whether there is proper assigning of authority and responsibility?
    - Are the business operations protecting the enterprise against frauds, errors or loss?
    - Are the financial records complete and truly accurate?
  - An illustrative checklist for Purchases is given in Annexure B. This checklist is based on "Internal Control Questionnaire" published by the Institute of Chartered Accountants of India ("ICAI"), as far as back in 1976. Checklists for other areas of operations should also be prepared.
- Preparation of Authority Signature Matrix (ASM):
  - The use of multi-layered class of authority in conjunction with the customised transaction limits by way of ASM draws a line of distinction between people who are entitled to authorise a transaction or particular set of transactions and those who are not so authorised.

- It being simple and definitive, serves as an ineffective tool for the implementation IFC over FR and hence must be prepared by every enterprise.
- ASM typically involves preparing a table for defining authorisation at each level for every process that takes place in the enterprise. For understandability, a simple format would have the various designations as column headings and each procedure as the row inputs.
- The intersection of the row and column input is where the authorisation limit will be defined.
- In case the person is not allowed to authorise a transactions, or, the procedure does not involve any authorisation, the concerned intersecting cell reflects "No authority".
- An illustrative ASM for Purchases is outlined below, on similar lines ASM should be prepared for other areas.

Sl. No.	**Positions** / **Steps**	**Assistant - Accounts and Finance**	**Executive - Accounts and Finance or CFO**	**Stores-in-charge**	**Executive/ Manager – Purchase**	**Chairman and/ or Managing Director**
A.	Vendor Selection and Registration					
1.	Selection of Vendor	x	✓	x	✓	✓
2.	Approval of Vendor Registration Form	x	✓	x	✓	✓
3.	Creation of party ledger	x	✓	x	x	NA
B.	Quotations, Proposals and Purchase Order generation					
1.	Invite Quotations from new vendors	x	x	x	✓	✓
2.	Purchase order for the vendor	x	x	x	✓	✓
C.	Receipt of Goods and Quality Checks					
1.	Purchase Challan/ GRN on receipt of goods	x	x	✓	✓	✓
2.	Shortage Memo if there is a difference in quantity as per the invoice	x	x	✓	✓	✓
3.	Quality Checks	NA	NA	NA	NA	NA
4.	Debit Note for claims on quality and short quantity	x	x	Up to ` 1,00,000	✓	✓
D.	Purchase Booking					
1.	Approval of Quantity in the Purchase Invoice	x	x	Up to ` 1,00,000	✓	✓

Sl. No.	Positions / Steps	Assistant - Accounts and Finance	Executive - Accounts and Finance or CFO	Stores-in-charge	Executive/ Manager – Purchase	Chairman and/ or Managing Director
2.	Booking of Purchase	x	✓	x	✓	NA
E.	Purchase Returns					
1.	Purchase Return Note	x	x	Up to ` 1,00,000	✓	✓
2.	Supplier's Copy of Debit Note	x	✓	Up to ` 1,00,000	✓	✓
F.	Payment Processing					
1.	Summary of payments	Up to ` 1,00,000	Up to ` 2,00,000	x	x	✓
2.	Generation of cheques	Up to ` 1,00,000	Up to ` 2,00,000	x	x	✓

– ASM could further be simplified and prepared in a bullet form, by indicating only persons who are authorised and by specifying limits.

- Preparation of Responsibility Allocation Matrix (RAM)
  - A simple RAM would suffice defining the roles and responsibilities of persons at all levels.
  - RAM is also prepared in a tabular format. It should ideally be prepared separately for each department. The relevant columns would be:
    - o Designation
    - o Name of the person
    - o Input (Documents to be received)
    - o Primary Responsibilities (Job expected to be done)
    - o Output (Approved documents)
  - An illustrative RAM for the accounts department outlined below; on similar lines, ASM should be prepared for other departments:

Designation/ Name of the person	Input	Primary Responsibility	Output
Assistant - Accounts and Finance	Approved PO from the Manager – Purchase and the Director	Retrieves purchase challan in the accounting system	Approved PO and Purchase Voucher to the CFO
Executive – Accounts and Finance	Shortage Memo and Debit Memo from Stores in-charge	Prepares Debit Note for claims on quality, rate difference and short quantity	Debit Note to the Director for approval
CFO	Approved PO and Purchase Voucher from Assistant – Accounts and Finance	Verifies Purchase Voucher with supportings	Approved PO and Verified Purchase Voucher to the Director for approval

RAM and ASM put together could itself serve as a Process Flow Diagram and would to a very great extent address the requirement of IFC over FR for SMEs.

Auditor's Role

In a combined audit of financial statements and IFC over FR, the auditor expresses opinion on the adequacy and effectiveness of an entity's IFC over FR which is in addition to and distinct from the opinion expressed by the auditor on financial statements. Though the final objective of both the audits are not identical, the auditor must plan and perform audit procedures to achieve both the objectives in an integrated manner. Needless to add that recording of audit plans and procedures followed for IFC over FR, must also be sufficiently noted and form part of working papers as done for the audit of financial statements.

In SMEs, documentation of processes and controls would be in a variety of forms and it may not have SOPs and detailed Process Flow Diagrams, RCMs, either for all or many of processes. It may be available in some other documents, checklists, etc. Thus, the auditor should evaluate controls based on simple flowcharts, checklists, ASM and RAM, to the extent possible and available or while carrying out walkthrough tests, the auditor should understand the flow of transactions and assess effectiveness of built-in controls. Auditors should also resort to observation of activities, inspection of documentation, etc. as evidence for its evaluation of controls and its effectiveness.

Further, to evaluate IFC over FR of SMEs, the auditor should mainly consider – identification and evaluation of Entity-level Controls (ELC), evaluation alternative approach to the objective of segregation of duties, test the application controls in the shelf-packaged software, assess financial reporting competencies.

Entity Level Controls

ELC, sometimes referred to as soft controls are those that define an organisation's culture. These are controls which set the `tone at the top' and have a pervasive (far-reaching) effect on the company's internal control and therefore, evaluation of ELCs is a must. Controls related to the control environment, controls over management override, the company's risk assessment process, controls to monitor results of operations/other controls, controls over the period-end financial reporting process are some such ELCs.

The auditor's evaluation of ELCs could change the approach to testing the auditor otherwise would have performed on other control. Based on the evaluation, the auditor might decide to rely on controls and reduce substantive testing or perform substantive testing without relying on controls. Based on the precision of ELC, auditor might be able to reduce testing of controls over relevant financial statements assertions. For example, an Accounts Officer prepares Bank Reconciliation Statements (BRS) as per the pre-determined schedule and the Owner-director or senior manager, with experience in accounting, reviews BRS effectively on a monthly basis, and if all these are appropriately documented, on the basis of evidence thereof, auditor could reduce the direct testing of the reconciliation controls.

Control environment, though have an indirect effect, because of its importance to effective IFC over FR, the auditor should assess the management's philosophy and operating style promote effective IFC over FR, whether integrity and ethical values are developed and understood and the role of Board or Audit Committee to understand and exercise oversight responsibility over IFC over FR.

Controls over management override are important to effective IFC over FR and more particularly, for SMEs. Some such controls are – maintaining integrity and ethical values, active oversight of the Audit Committee or the Board of Directors, maintaining a whistle blower programme, controls over certain journal entries.

Enforcement of integrity and ethical values

Evaluation

- Check whether policies such as Vision and Mission Statement, Code of Conduct or Ethics Policy and Human Resource Policy are in place.
- See that the same are communicated to all employees, if there is no formal communication, assess through discussions with employees.
- Auditors may also rely on his past experience with the company.

Whistleblower Programmes

A whistleblower programme acts as venting out for employees or others to communicate to the top management regarding violation of company's policies and procedures.

Evaluation

- Check whether or not a whistleblower programme is in place. Look out for suggestion/ grievance boxes, communication memo, or a separate e-mail address in place reserved for the purpose.
- Conduct inquiries and ask employees about its existence.
- Confirm from employees who have in fact put forward a communication, about follow-up of their grievance.

Oversight Audit Committee or Board of Directors

Independent Audit Committee or the Board of Directors identifies areas in which the management override of internal control could occur and evaluates the risk of management override.

Evaluation

- Check the minutes of the meetings to evaluate the effectiveness of.
- Have a discussion with the Directors for the extent of their involvement and asking them about monitoring of certain transactions (mainly related party and exceptional transactions like purchase of property, etc.) for mitigating risk of management override.
- Test the mitigating controls so obtained (Such as reviewing the whistleblower from time-to-time, evaluating the reasonableness of the management's judgments and assumptions to apply certain policies).

Controls over Journal entries

It is to prevent or detect unauthorised journal entries that are intended to lead to material misstatement of financial statements.

Evaluation

- To understand how journal entries are recorded, whether there is a periodic review thereof and whether there is a restricted access for passing such entries?
- To check whether there is a control to prevent and detect unauthorised journal entries, either in the general ledger or directly to the financial statements.

While dealing with the risk of management override, the auditor should assess the ROMM due to fraud. Based on his experience and skepticism, the auditor should evaluate -

- How and where the management could override controls to engage in or conceal fraudulent financial reporting? What opportunities does the management have to override?
- What event or conditions that incentivise the management to override controls?

Further, the auditor should also consider:

Approach to Segregation of Duties

SMEs, having very few employees, may not be able to implement segregation of duties. Example, the entire accounts is handled by one person, from booking of entry to approving all transactions. Thus, where there is a shortage of personnel at the operational level, the approval of the owner-director becomes an alternative control, subject to risk of management override.

Evaluation

– Check whether segregation of duties exists, since that is the best what can ever be.

– In the absence thereof, to identify the implementation of alternative controls as reviewing of transactions/reports, checking reconciliations, taking periodic physical counts. Example, though all the transactions are booked and approved by the same person, the application system does not extract transactions to the financial statements without the approval of the top management, say, the owner-director or CFO.

  Auditor should check whether the alternative controls meet the related control objectives.

– Another alternative control could be use of services of external parties, like consultants or temporary employees, to ensure segregation of duties and hence, the maker-checker concept could be in place. This is done for specialised and important functions, as payroll processing, securities record-keeping or say, on a temporary basis for the period-end financial reporting process. Auditor may evaluate the same manner as other controls but to check the competence of such agencies.

Period-end financial reporting process

The objective of period-end financial reporting process is to ensure identification of the issues (due to altogether new transactions, changes in accounting standards, etc.) on a timely basis and the competence of the accounting team for the preparation and presentation of financial statements and disclosures as per the requirement of generally accepted accounting principles, accounting standards and the provisions of the Act as also timely completion of the reporting process. The accounting team should at least be sufficiently competent to deal with the requirement.

Financial reporting competencies could be evaluated based on auditor's previous experiences with the auditee, knowledge about certain accounts and disclosures. If there is an involvement of outside professionals for accounting and/or the period-end process, the auditor should evaluate the oversight of the management in this regard, that is, the management recognition of the fact additional assistance or expertise is required, its overseeing, reviewing and control over the work of outside professionals.

Further, the auditor should broadly evaluate the year-end reporting process of the following aspects:

Procedures for the preparation and presentation of Financial Statements in accordance with Schedule III of the Companies Act, 2013, Accounting Standards and other reporting requirements – persons involved, including those involved from the management, and their competencies, – timely completion – review - approval and documentation of workings prepared – checklist for the financial reporting closure

Procedures for selection and application of accounting policies – based on applicable accounting standards and after the approval of management

Procedures for the accounting treatment of significant and unusual transactions or estimates and assumption involved – based on appropriate supporting,

judgements or accounting policies of the company – based on the approval of the top management

Procedures for dealing with changes in laws and regulations – meeting with persons involved – external consultations, mainly for its accounting

Maintenance of user profile and other IT risks – extent of involvement of IT in the process - proper the accounting software system – automatic totals of transactions in the general ledger – automatic posting even in the financial statements - prevention and detection of modification of original entries – not allowing passing of back-dated entries – defining of various access, posting, review and approval rights – security and password protection and other related IT Controls.

Having carried out the exercise of evaluation of IFC over FR, the auditor is required to submit a report on IFC over FR.

Broad comments in Audit Report

The Act does not provide whether a separate report of IFC over FR to be given or it can be incorporated in the existing report. Depending upon the company's business activities and policy of the audit firm, appropriate decision may be taken for the manner of reporting. General practice has been to give a separate report. The Guidance Note on "Audit of Internal Financial Controls Over Financial Reporting" permits both options. In any case, the auditor may need to incorporate his opinion (unmodified / unqualified opinion) or on similar lines, as specified infra:

Opinion

In our opinion, the Company has, in all material respects, an adequate internal financial controls system over financial reporting and such internal financial controls over financial reporting were operating effectively as at March 31, 2016, based on the internal control over financial reporting criteria established by the Company considering the essential components of internal control stated in the Guidance Note on Audit of Internal Financial Controls Over Financial Reporting issued by the Institute of Chartered Accountants of India.

Conclusion

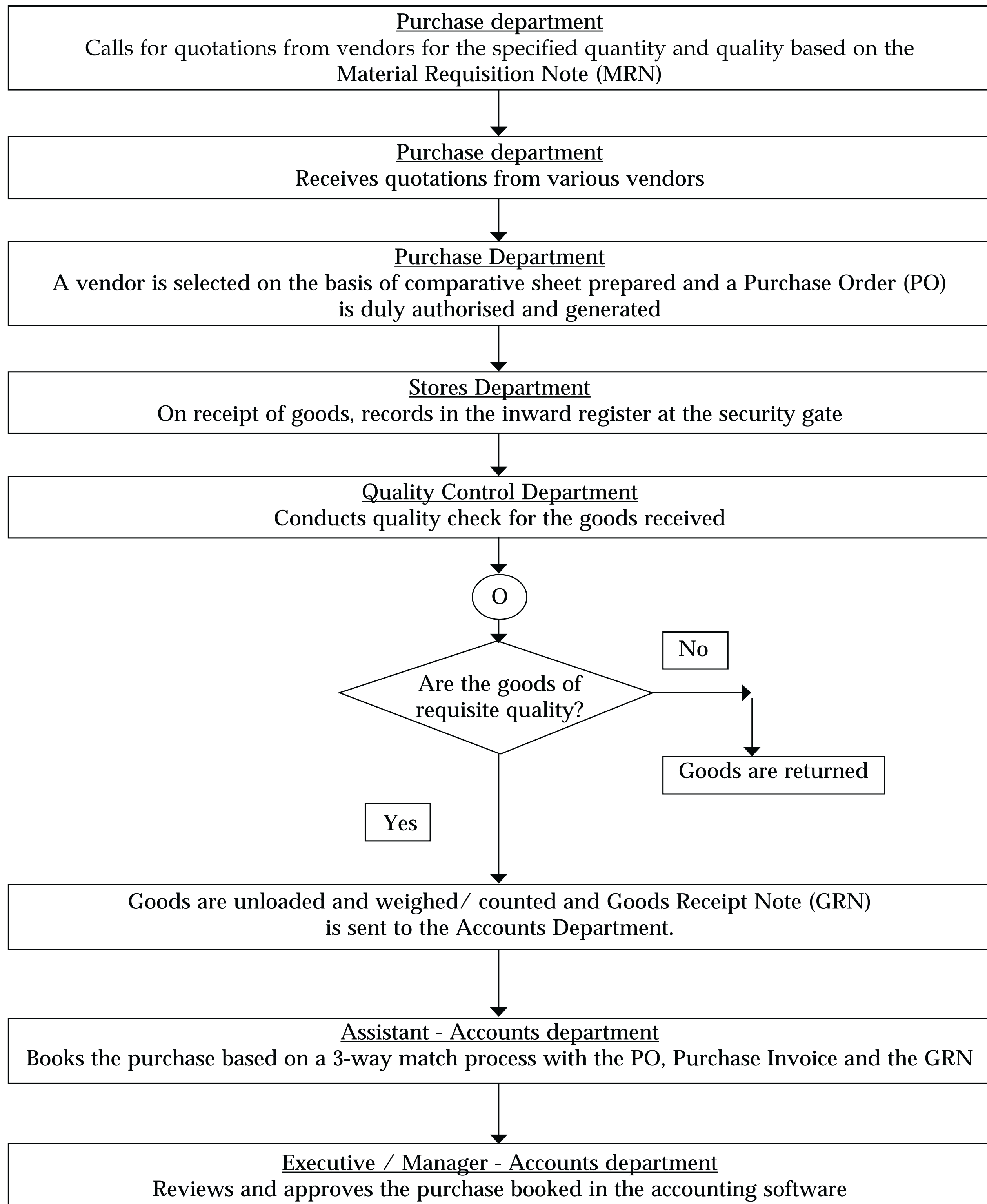
IFC over FR has now become an important aspect of any company, whether large scale or an SME. To have effective IFC over FR, will involve efforts and cost for any enterprise. However, IFC over FR has benefits for a long time to come and despite its challenges, IFC over FR can be implemented in SMEs. We are sure that the reliability of IFC over FR will bring down the instances of frauds and errors and thus, bring value to all stakeholders. Statutory auditors will have to perform the special duty bestowed upon them under the provisions of the Act regarding providing opinion on IFC over FR with the utmost diligent and in the spirit and in law. There is no doubt that the Chartered Accountants have and will gear-up to meet the challenges of the new reporting.

Acknowledgement

I acknowledge my gratitude to professional colleagues (without specifically naming anyone) whose presentations/articles on this subject from which I have drawn inputs and inspiration for this article. Of course, I have also relied upon the Guidance Note on Internal Financial Controls over Financial Reporting Published by the Institute of Chartered Accountants of India.

I also thank my assistant Miss Priyanka Saraf to carry out the utmost efforts for the preparation of this article.

Annexure A
Flowchart for Purchases



Annexure B

Checklist for Purchases and Creditors

Vendors' Selection and Purchase Orders (POs)

1. - Whether a list of approved vendors is maintained?
   - Are purchases made only from such approved vendors?
   - Whether the master list contains more than one source of supply for all-important materials?
2. Are the POs (based on valid purchase requisitions, if generated) duly signed by person authorised in this behalf?
3. Is special approval required for: Purchase (whether capital goods or regular materials) from employees and Key Managerial Personnel or Related parties?
4. Are POs placed based on competitive quotations from two or more suppliers?
5. Whether comparative quotation analysis sheet is drawn before POs are authorised?
6. Are POs pre-numbered and strict control exercised over unused forms?
7. In case of revision of terms of POs, whether the same are duly authorised?
8. Are copies of POs (or revision thereof) forwarded to Accounts and Stores Departments?
9. Whether a list of pending POs complied by the Purchase Department at periodic intervals?

Receipt of Materials

10. - Are all materials, supplies, etc. received only in the Stores Department?
    - If they are received-directly by User Department / Processors / Customers, is there a procedure of obtaining acknowledgments for the quantity received and the condition of the goods?
11. Are persons connected with receipt of materials and the keeping of receiving records denied authority to issue POs or to approve invoices?
12. Are materials/supplies, inspected for quality/condition and counted, weighed or measured in the Stores Department?
13. Are all receipts of materials evidenced by pre-numbered Goods Received Notes (GRNs)?
14. Are copies of GRNs forwarded to Accounts Department and a list of goods received to Purchase Department?
15. Are all cases of materials returned, shortages and rejections advised to the Accounts Departments, for raising Debit Memos on suppliers or claim bills on carriers insurance companies, as the case may be?
16. Are all debit notes and other related documents - pre-numbered and numerically controlled? Are those properly recorded (in the financial accounts or in memorandum registers, as the case may be)?

Suppliers' Invoice

17. • Are all suppliers' invoices (Purchase Bills) routed to the Accounts Department?
    • Are these bills forwarded to other department or authorised person for check and / or approval?
    • Are advance and partial payments entered on the invoices before they are submitted to other departments?
18. Does the systems ensure that all invoices and credit notes received are duly processed?
19. Whether entries are made to record the receipts into stock records? Whether the same are reconciled periodically with the Purchase Bills as well as physical verification?
20. Are duplicate invoices marked immediately on receipt to avoid payment against them? Are adequate precautions taken to avoid duplicate payments?
21. Does the Accounts Department match the invoices of suppliers with GRNs and/or POs?

Cut-off procedure

22. • Are GRNs and receiving records regularly reviewed for items for which no invoice has been received?
    • Are all such items investigated and is provision made for the liability in respect of such items?

    Note – As far as possible, such review or investigation is to be done by a person independent of those responsible for the receipt and control of goods?
23. Are all invoices checked for prices, freight terms, extensions and additions?
24. Is the relative PO attached to the invoice for payment?

Creditors' Account

25. Where the client both buys from and sells to a person regularly, is a periodic review made of all amounts due from that person to determine whether any set off necessary?
26. • Is a special request used for making payments in advance or against documents through Bank?
    • Thereafter, are the invoices processed in the normal course?
27. • Are all advance payments duly authorised by persons competent to authorise such payment?
    • Is a list of pending advances made at least every quarter and is a proper follow-op maintained?
28. Are all adjustments to creditors accounts, duly approved by authorised persons?
29. Are confirmations obtained from suppliers? Whether all suppliers' statements compared with ledger accounts? Whether follow-up action is taken to reconcile differences, if any, between the suppliers' statements and the ledger accounts?
30. Is a list of unpaid creditors prepared and reconciled periodically with the Control Accounts?

Others:

31. Is a list of employees by designation, with limits of authority in respect of several matters referred to for the purchases is maintained?
32. ……. Further points may be added considering the nature of enterprise.

CA Sriraman Parthasarathy

Tenure of Do's and Don'ts for Company Auditors!

Background

We are living in an environment where it is expected that one has to demonstrate his *bona fide* beyond doubt, in letter and spirit, and in substance and form! Today Perceptions, Inhibitions and Notions play an important role in determining the credibility of a person. No one is ready to listen to you for a detailed explanation in this fast moving world. Even if you drink apple juice in a bar, the outsider is not going to believe you or give you the benefit of doubt and he may consider you to be a "drunkard"!

Audit being a noble profession which thrives on trust and professional competence also needs to evolve and fine tune itself to manage the new expectations and the changed environment! With more and more emphasis on governance and the transparency, it is but natural that a trusted profession has to be insulated from such bias arising out of false notions. The integrity and professional acumen of an auditor should never be allowed to get challenged in the light of perceived bias and inhibitions!

The Companies Act, 2013 has made several path breaking changes impacting the audit profession significantly. Whilst it is generally felt that majority of the changes have emanated as a knee jerk reaction to various accounting scandals including the Satyam scam in the country, which has shaken up the accounting world, one should not forget that lot of catch up needs to be done by the Regulators to compensate for letting the environment loose for over 50 years post the enactment of the Companies Act, 1956 considering that the world has moved forward pretty fast! No doubt that the regulatory blow will be heavy when the impact hits in one full swing, and perhaps it could have been given in smaller doses over a period of time; but time was running out for the Regulator to protect and restore the public confidence over the profession. In effect, the audit profession has been completely transformed under the new Companies Act, 2013 to protect and of course project its image of independence by law!

This Article aims to summarise some of those significant changes which prescribes the Do's and Don'ts for an auditor, its background, the implementation challenges and the ground level reality of the intended and the actual benefits.

Auditor rotation – Auditors in the New World!

Whether familiarity with the client would result in compromising the quality of the work? Would a fresh pair of eyes pick up something different? When you are doing things again and again, would it not result in complacency in the system? How would the auditors ensure independence in a known environment?

All these questions ultimately ended up with the concept of Rotation of auditors. Whilst it is still a hot topic with contradictory views, the new Companies Act, 2013 has gone ahead and mandated the rotation of auditors for select companies. Whilst audit rotation has got its own merits and demerits, one thing is certain that the implementation is going to throw a lot of practical challenges in this period of mammoth regulatory developments.

Under the new Act, listed companies and other companies belonging to the prescribed class cannot appoint or re-appoint the same auditor for more than two terms of five consecutive years, if the auditor is an audit firm and more than one term of five consecutive years, if the auditor is an individual. The prescribed class of companies apart from listed companies, include;

- All non-listed public companies having either (i) paid-up share capital of ` 10 crore or more, or (ii) public borrowings from financial institutions, banks or public deposits of ` 50 crores or more.
- All private limited companies having either (i) paid-up share capital of ` 20 crore or more, or (ii) public borrowings from financial institutions, banks or public deposits of ` 50 crores or more.

The auditor, who has completed his term, will not be eligible for re-appointment as auditor in the same company for five years, which is a cool off period, from completion of the term. The same restriction applies to the audit firm which has common partners with the outgoing audit firm at the time of appointment. Whilst the existing auditor would make every effort to keep his relationship live with the client, he should not render any services during the cool off period which would make him ineligible for his reappointment post the cool off period.

The Companies Act, 2013 provides for a transition time of 3 years for meeting the rotation requirements. Whilst some of the large entities in India have already changed their auditors, the real impact of audit rotation would be felt by the corporate community in India only from the FY 2017-18 being the year where the new auditors for several companies would be auditing the financial statements. In the rotation regime, we all will end up seeing various exciting things; there will be a grass root level understanding of the business and operating environment by the new auditor, the views taken earlier may be re-evaluated, healthy professional debate, and finally a sense of satisfaction for the corporates when there is an endorsement of its numbers from a new auditor!

Challenges are many!

Rotations has come at a crucial time when several new things are being dealt with by the Indian Corporates! When the corporates are transitioning to IFRS through Ind AS, and are coping up with the Indian SOX equivalent requirements of Internal Controls over Financial Reporting and getting ready for the new Tax Accounting Standards, the auditor rotation is going to add to the burden of the corporates and also the professionals in understanding and appreciating each other to get ready for the "special purpose marriage" for a period of 5 years or 10 years in the newly drawn path!

Whilst for the large and listed entities, the requirement for rotation makes more sense, extension of the same to private companies/ closely held set ups based on the paid-up capital would make the ease of doing business more difficult. Especially, multinational entities which are governed under their own laws/rotation requirements, would face tremendous challenges in meeting multiple regulatory requirements which could, at times, be conflicting.

From the view point of corporates, selection of a new auditor is also not an easy task! It is something similar to selecting your own family doctor! Upfront and careful selection of the auditor duly considering the credentials, industry expertise, team skills, reputation, independence, commercial considerations, etc. are all important in making the right choice. Many corporates have resorted to the practice of

evaluating the competent audit firms based on a predefined scoring mechanism duly customised for the entity for its size, nature, expectations, etc. developed professionally for ensuring a credible and transparent approach. Others have gone ahead with their own limited/internal assessment and identified their new auditors!

Rotation is going to be challenging not only for the corporates, but also for the new auditors! The Auditor should also carefully assess the rotation requirements and ensure that he complies with the requirements of the law totally before offering himself for appointment and providing the eligibility letter. Whilst rotation has been introduced for the purpose of bringing in transparency, the professionals should make sure that the same does not result in commoditising the audit and result in denting the audit quality by compromising the core principles of the audit. They should also make sure that the required understanding/knowledge of the entity / industry is picked up at the earliest. The scope for undetected frauds during the rotation period could be high due to things falling between the cracks.

No Entry for Disqualified Auditors!

According to “The Economist”: November 2004 edition, “No one becomes an auditor because the job is adventurous. In recent years, however, the profession has been really rather racy. Auditors have been implicated in fraud after fraud”.

This concern has resulted in regulators across the world building several firewalls statutorily to make sure that the professional responsibilities are clearly defined and the Lakshman Rekha for associating with the client is also drawn without any ambiguity!

Amongst various other disqualification factors, the new Companies Act stipulates that a person is not eligible for appointment as auditor if he himself, his relative or partner holds any security or interest or is indebted or has given any guarantee or provided any security in connection with indebtedness of any third person to the company, or its subsidiary, holding or associate company or subsidiary of such holding company.

Whilst there are certain monetary ceilings stipulated under the Act with respect to the above, the limits are more from a materiality perspective rather than as a principle cutoff.

Further, to take care of the specific concern of the perceived cozy relationship of the auditors and the corporates, under the 2013 Act, a person or an audit firm are not eligible for appointment as auditor, if they/it, directly or indirectly, has business relationship with the company, its subsidiary, its holding, or associate company or subsidiary of such holding or associated company. There are detailed clarifications as to what is considered as business relationship. As a simple rule, one should remember that business relationship is something which could restrain the auditor from expressing his independent opinion.

In accordance with the 2013 Act, a person or a partner of a firm will not be eligible for appointment, if such person or partner at the date of appointment/reappointment holds appointment as auditor of more than 20 companies. Private companies are also included in the maximum limit of 20 companies. The ceiling put by the Regulator for the audit profession is more to ensure quality. Though it is debatable in terms of the logic of the number of 20, one should remember that the auditor should do justice to his job and should not look at converting the profession into a business/ commercial proposition by accepting work beyond his capacity just for the purpose of making more profits!

The new Act also stipulates that a person is not eligible for appointment as auditor, if that person has been convicted by a court of an offence involving fraud and a period of ten years has not elapsed since such conviction. This would ensure high standards of integrity for protecting the image/credibility of the profession.

Whilst there are several restrictions which have been included to make it mandatory for the

auditors to comply with the provisions of the law, the extent of implementation of the above would pose insurmountable difficulties. For example, the extent to which the auditor will be in a position to obtain, provide and control the holding of the relative of the auditor who lives independently is any ones' guess! One should always remember that the restrictions are to demonstrate the independence of the auditors to those who trust the certified numbers with implicit faith and make their decisions. If this aspect is considered by the auditors, the necessary actions will certainly follow.

Other Services for Auditors Not Allowed!

Joseph Lieberman, a Senate Committee member in 2002 once commented that "Gatekeepers weren't keeping the gate, watchdogs weren't watching"

When public sentiment goes on the above lines thanks to the globally observed accounting scandals and business failures, one should carry out the root cause analysis. As part of that exercise, the regulators believe that the auditor, when he renders attest services, should not have any other relationship with the client which would conflict with his own discharge of duties. Whilst the debate on what is to be restricted and what not, can go on, the fact remains that the auditor should never render any service on which there is a self-review threat.

Under the new Act, the Auditors are not allowed to provide certain specified non-audit services either directly or indirectly to the company, its holding company or subsidiary.:

- o Accounting and book keeping services
- o Internal audit
- o Design and implementation of any financial information system
- o Actuarial services
- o Investment advisory services
- o Investment banking services
- o Rendering of outsourced financial services
- o Management services
- o Any other kind of services as may be prescribed

The term "directly or indirectly" shall include rendering of services by the auditor;

- in case of auditor being a firm, either by itself or through any of its partners or through its parent, subsidiary or associate entity or through any other entity, whatsoever, in which the firm or any partner of the firm has significant influence or control, or whose name or trade mark or brand is used by the firm or any of its partners;
- in the case of auditor being an individual, rendering of services either by himself or through his relative or any other person connected or associated with him through any other entity, whatsoever, in which such individual has significant influence or control or whose name or trademark or brand is used by such individual.

An auditor or audit firm who or which has been performing any non-audit services on or before the commencement of this Act needs to comply with these provisions before the closure of the first financial year after the date of such commencement.

If there are any permissible services for the auditor, he will be allowed to provide only such non-audit services to the company as are approved by its board or audit committee.

The provisions relating to proscribed services above would result in making the audit job more and more specialized. Further, the list of such proscribed services that are applicable in India currently is also on the similar lines of barred services in various international jurisdictions.

Time to Demonstrate Professionalism!

Whilst the new Act prescribes various conditions and defines the boundaries for the auditors, there are certain key aspects which should never be forgotten and compromised. The changes that have been brought in may be for

dealing with the perception issue, but the fact remains that the dignity of the profession can be protected not because of these rules / provisions, rather only by way of demonstrating absolute professionalism!

In the era of transformation of the profession, the following key core values/principles/practices should be protected and nurtured;

- Maintaining Independence
- Absolute integrity
- Objective and Clear Thoughts
- Demonstration of Professional Competence
- Superior Audit Quality
- Looking at things from the eyes of the stakeholders
- Fight for the Right
- No Self Review Threat
- Demonstrate absolute confidence

Law cannot anticipate all the probable threats for independence or situations that would lead to conflict of interest; further, a provision in the law could also be interpreted differently by different people if someone is looking for an escape mechanism. What is required is compliance in letter and in sprit and not necessarily in form!

Rules and regulations cannot bring in discipline by force; at best they can only act as a moral deterrent; what is required is self-discipline and an intention to do things which will uphold the dignity of the profession.

An Auditor should do things which are expected from a respected/reputed professional and should keep away from doing all things which would dent the image of the profession! The simple rule to judge what is required/what is not required would be to apply the concept of evaluating your decisions as an independent third party.

Based on such evaluation, if you believe that what you have done makes sense, continue to do it with more confidence; on the other hand, when you are not clear or are having doubts, re-evaluate the decision, have consultations with fellow professionals and based on the same, if you conclude that the decision is not correct or falls in the darker side of the grey, have an open mind to change it and bring it back into the right path!

Conclusion!

How can auditor who is selected by the promoters/management in reality and paid for his services by the same promoters/ management can challenge the management and its numbers and provide an independent assessment? Whether all the restrictions stipulated by the Act would make the audit profession perfect by itself? Whether Auditor Rotation is a panacea for the problems associated with the financial irregularities in corporates? Whether the extent of punishments stipulated in the Act can create a fear element to keep away from doing wrong things? These are some of the questions that can be asked in the context of the changes being introduced by Regulators. However, one should note that Law by itself cannot change human nature, but can certainly provide the framework to develop good human beings and make them understand the rules of the game!

The audit profession is a noble one which thrives on trust, professional competence and the confidence reposed by a third party. Expectations of the society from auditors are much more. The credibility attached to the professional product will be distorted if the basic confidence gets eroded. The core values of the profession should always be kept intact and it is the responsibility of each and every professional to cherish the same and act to enhance it further. The Companies Act, 2013 would certainly go a long way in setting the tone and making the expectations clear from the auditors; and now it is the turn of the professionals to implement it flawlessly and make this noble profession reach newer heights!

The views expressed in the Article are the personal views of the author.

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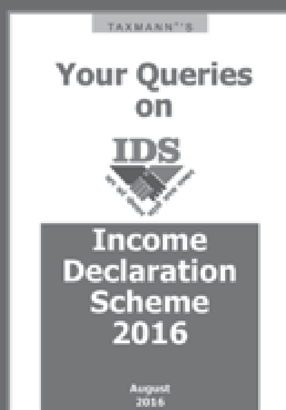

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Bharat Raichandani, *Advocate*

HOT SPOT
Stirring the Hornet's nest OR light at the end of the tunnel?

The recent ruling by the Hon'ble Delhi High Court in the case of *Suresh Kumar Bansal vs. Union of India and Ors.*[1] has thrown open many questions, some legal, some real and some practical.

Stated briefly, the facts were thus: The petitioner was an individual. He entered into an agreement with the builder for purchase of flat. The builder in addition to the consideration for the flat had collected service tax from the petitioner. The petitioner, *inter alia*, challenged the Constitutional validity of levy of service tax on services "in relation to construction of complex" and the explanation added to the said section with effect from 1-7-2010. There was also a challenge to levy of service tax on preferential location service as well. The dispute related to period prior to July, 2012 i.e., prior to introduction of levy of service tax under the Negative List regime.

One of the main contentions, *inter alia*, amongst others, raised by the petitioner was that neither the Finance Act, 1994 nor the rules made thereunder provided any machinery provision for ascertaining the value of service component in a composite contract of the present nature which includes provision of service, transfer of title in goods along with transfer of title in immovable property.

The Hon'ble High Court repelled the challenge to the Constitutional validity of the explanation to section 65(105)(zzzh) of the Finance Act, 1994. The High Court observed that it was within the legislative competence of the Union Legislature to tax the service aspect involved in the present transaction by way of a deeming fiction and there was no impingement of the legislative field reserved for the States. In doing so, the High Court applied the doctrine of pith and substance.

However, the High Court went on to examine the provisions of the Finance Act relating to Valuation (Section 67 read with the Service Tax (Determination of Value) Rules, 2006) and held that there is no provision for Valuation of services involved in a composite contract of the present type. Thus, the High Court concluded that in absence of valuation mechanism provided

1. Judgment dated 3-6-2016 in WP No. 2235/2011

in law, no levy can be attracted. It was held that for any levy to be sustained, it must satisfy the following tests cumulatively: (i) Taxable event (charging section); (ii) Taxable person (on whom the levy is imposed and who is liable to pay the tax); (iii) Rate of tax at which it is imposed and (iv) Measure of the levy (value to which the rate is to be applied for computation of tax liability).

In sum, essentially, the High Court ruled that if the machinery fails; so must the levy. Consequently, the High Court concluded that no service tax can be demanded in absence of provision for valuation, in law. The High Court reiterated the principles laid down by the Hon'ble Supreme Court in the case of *Mathuram Agarwal*,[2] *Govind Saran Ganga Saran*[3] and B. C. *Srinivasa Setty*[4] case. The High Court heavily relied upon recent judgment of the Supreme Court in the case of *Larsen & Toubro Limited*[5] (in the context of levy of service tax on works contract service). The High Court also held that abatement notifications cannot substitute for the Act or the Rules.

The High Court has, however, added a rider that the provisions post July, 2012 are not being examined as the said controversy is outside the scope of the challenge.

Per contra, it must be noted, in a similar fact situation, the Hon'ble Madras High Court in the case of *N. Bala Baskar*[6] held that the purchaser has no *locus standi* to challenge the levy of service tax or Circular issued by CBEC. Accordingly, the petition therein was rejected.

In light of the said ruling of the Hon'ble Delhi High Court, several questions would arise from point of view of various stakeholders.

From the point of view of the Central Government, the said ruling would be required to be challenged before the Hon'ble Supreme Court in as much as the said judgment would have widespread ramifications and amount of Revenue, at stake, would be substantial. In the event of the Hon'ble Supreme Court not interfering thereto or refusing stay of operation, would a retrospective amendment be resorted to? Will the Union resort to the old motto of the Revenue Services of a leading country: "We have what it takes to take what you have".

From the point of the view of the builder/developer (service provider), the following situations would emerge:

a. Whether the builder can claim refund of service tax from the department for the period prior to July, 2012? Would question of unjust enrichment arise?

b. Whether, going forward, service tax needs to be collected and paid to the credit of the Central Government or not? If yes, whether the said should be paid 'under protest' or not?

c. Whether service tax can be collected and kept in an escrow account, pending decision of the Supreme Court, if the said judgment is challenged? Would the provisions of Section 73A of the Finance Act, 1994 come into play in such situations?

d. Whether the flat purchaser can sue the builder in civil Court for recovering

2. (1999) 8 SCC 667
3. (1985) 155 ITR 144 (SC)
4. (1981) 2 SCC 460
5. (2016) 1 SCC 170
6. 2016-TIOL-824-HC-Mad.

service tax contrary to law laid down by the High Court?

e. What would the position be, if some flat purchasers reimburse service tax while others do not?

f. If the builder does not collect and pay service tax, would interest and penal consequences visit him?

As Ronald Reagan once said, "A tax-payer is someone who works for the Federal Government, but does not take a civil service exam".

From the point of view of the flat purchasers (service receiver), the following questions would arise:

a. Whether service tax needs to be reimbursed to the builder or not? If yes, what are the precautions to be taken?

b. Whether the flat purchaser can claim refund of the service tax paid to the builder from the builder?

c. Whether the flat purchaser needs to file a claim for refund of service tax already paid? Would time limit of one year under Section 11B of the Central Excise Act read with Section 83 of the Finance Act, 1994 be applicable in such cases? If yes, what would be the relevant date i.e., date of payment of service tax or date of this judgment?

d. Whether the said judgment would be applicable only in the case of the petitioner therein or would apply equally to other flat purchasers as well? Would the said judgment be applicable in Mumbai, not being from the jurisdictional High Court?

e. Whether the said judgment would apply for period post July, 2012 or not, as the valuations provisions continue to remain the same?

People who complain about taxes are not consumers, but men and women.

Apart from the above, we must watch out, whether the said judgment would be applicable in the case of redevelopment of societies or not? Similarly, it also needs to be seen, whether the said judgment would be applicable in the case of sale of Transfer of Development Rights (TDR) and in the case of Joint Development agreements?

All in all, the above judgment would have far reaching impact on the entire real estate industry *per se*. As Quest, once said, only time will tell, time is always telling and time never stops telling.

My message, especially to young people is to have courage to think differently, courage to invent, to travel the unexplored path, courage to discover the impossible and to conquer the problems and succeed. These are great qualities that they must work towards. This is my message to the young people.

— Dr. A. P. J. Abdul Kalam

Sonali Mahesh Borase

Religion & Terrorism

Once upon a time, a man was presented before the court because he had killed a stranger who was sitting on the beach. He had never seen the stranger. They had never met so there was no question of enmity. He did not kill him for money. He did not even know how that man looked because he stabbed him from behind with a big knife. The magistrate could not figure out his motive and so he asked the murderer, "Why did you do it?" The man said, "When I stabbed that man with a knife and a fountain of blood came out of his back that was one of the most beautiful moments I have ever known. I am aware that for this pleasure I will have to pay with my life. But I am ready for that. That one moment of pleasure was worth all the pain and the possible death penalty that I will have to encounter. My whole life I have lived in boredom – no excitement, no adventure. So I finally decided to do something about it. And this act has made me world famous; my picture is in every newspaper. And I am perfectly happy that I did it."

This is probably the direction in which a terrorist's mind works. When Kasab was interrogated by the police on what he thought was 'jihad', he said that 'jihad' was about killing and getting killed and becoming famous, by killing one will become famous and will also make God proud.

This man in the above story was simply bored with life and he wanted to do something that made him feel significant, important. He wanted to be a celebrity... just ordinary human desires. He was happy that all the newspapers had his photo. And he was ready to pay with his life to, at least for one day, be known to the whole world and be recognized by everybody.

When a person with no purpose whatsoever can commit a murder of this kind, it comes as no surprise that people are willing to carry out gruesome and inhuman activities which kill others in order to protect what could possibly be one of the purest beliefs of man – religion.

Religion has been in existence ever since the birth of man. Different religious traditions have played a major role in the evolution of society.

"Each religion has helped mankind. Paganism increased in man the light of beauty, the largeness and height of his life, his aim at a many-sided perfection; Christianity gave him some vision of divine love and charity; Buddhism has shown him a noble way to be wiser, gentler, purer, Judaism and Islam how to be religiously faithful in action and zealously devoted to God; Hinduism has opened to him the largest and profoundest spiritual possibilities."[1]

1. Sri Aurobindo "Essays in Philosophy and Yoga", p. 211

In the above excerpt from 'Essays in Philosophy and Yoga', Sri Aurobindo highlights the equality in religion. No religion is the more supreme one. Every religion has contributed in numerous ways to the development of man.

Today, most people follow either a monotheistic religion that advocates worship of a single God or a henotheistic religion i.e. a religion that acknowledges other Gods, heroes, saints along with the main deity. However, the type of religion followed by individuals does not influence its teachings. All religions profess the principles of forgiveness, generosity, love thy neighbour, do unto others what you would have them do unto you, speak the truth, you reap what you sow, among others.

Nobody knows with accuracy how religion evolved. By the time writing had developed, many religions had been in place for many millennia and the details of their origin had been long forgotten. However, speculations indicate that religion was born as a result of human fear. Religion made humans feel more secure amidst the insecurities of the world. It assured them of a protector who would safeguard them from danger and all things evil. It gave man hope and mental strength in times of despair and the promise of a better tomorrow. Religion assured people of a hand to hold when all seemed lost and they had nowhere to go. It was powerful enough to inspire people's potential and make them undaunted even in the face of death.

John Shelby Spong who is a retired bishop of the Episcopal Church in USA once commented that, "Religion is primarily a search for security and not a search for truth. Religion is what we so often use to bank the fires of our anxiety. That is why religion tends toward becoming excessive, neurotic, controlling and even evil. That is why a religious government is always a cruel government. People need to understand that questioning and doubting are healthy, human activities to be encouraged not to be feared. Certainty is a vice not a virtue. Insecurity is something to be grasped and treasured. A true and healthy religious system will encourage each of these activities. A sick and fearful religious system will seek to remove them."

One can conclude that religion was partly a response to human fear. Likewise, terrorism too is born out of fear. Where religion is what gives man the strength to face his fears, terrorism is what he succumbs to when this very source of his strength is threatened.

Terrorist activities are usually violent activities intended to coerce or intimidate governments or societies to give in to the demands of a particular group. Terrorism is used as a means to draw attention of the local and world population to a particular cause. The terrorist attacks are planned in such a way so as to obtain the greatest publicity. Most attacks are conspired to be committed at places of commercial or national importance so as to impact maximum number of people. This trend is observed in the terrorist attacks that took place in New York City and Mumbai in 2001 and 2008, respectively.

The attacks in New York City on September 11, 2001 were terrorist attacks by the Al- Qaeda targeting the symbolic World Trade Center. These attacks caused serious damage and destruction not only to the World Trade Center and the nearby infrastructure but also to the economy of Manhattan which was crippled for a week due to the closure of Wall Street. Many closings, evacuations, and cancellations followed out of fear of further attacks. The 2008 attacks in Mumbai were executed at Taj Mahal Palace Hotel and Oberoi Trident, among other sites which were places of importance and guaranteed to be bustling with people.

The main aim of terrorists is to induce fear in the minds of people to get their wants and demands fulfilled. For instance, in October 1983, Middle Eastern terrorists who were a part of the Iranian and Syrian-supported Hezbollah organization bombed the Marine Battalion Landing Team Headquarters at Beirut International Airport, Lebanon. Their immediate victims were the 241

U.S. military personnel who were killed and many others who were wounded. Their true target was the American people and the U.S. Congress. Their one act of violence influenced the then President Ronald Reagan's decision to withdraw the Marines from Beirut and was therefore considered a terrorist success.

The above incident is an example of secular-based terrorism. Where the objective is related to religion, terror attacks can be said to be cowardly reactions of some people to their innate insecurities related to their religion which could be the declining number of people who belong to their religious community or the gradual annihilation of their religious traditions and principles. These insecurities could be attributed to reasons varying from increasing instances of people converting to other religions to greater acceptance of inter-religion marriages, both of which result in reduction of people of that community. Intolerance towards other religions and a burning desire for their own religion to be considered greatest and the most supreme also drive people to commit terrorist activities.

The difference between religion-based terrorism and secular-based terrorism can be understood from Bruce Hoffman's book 'Inside Terrorism'.

Bruce Hoffman in his book says that for a religious terrorist, violence is a sacramental act or divine duty that he executes in direct response to some theological demand or imperative. Thus religious terrorism surpasses any other reasoning and terrorists disregard the political, moral or practical constraints that may affect other terrorists. However secular terrorists, even if they have the capacity to do so, rarely attempt indiscriminate killing on a massive scale because such tactics are not consonant with their political aims and therefore are regarded as counterproductive, if not immoral. They do not believe in harming people or places that have no relevance with their objective. But religious terrorists often seek the elimination of broadly defined categories of enemies and accordingly regard such large-scale violence not only as morally justified but as a necessary expedient for the attainment of their goals. These terrorists are mostly influenced by the messages conveyed by sacred text and imparted via clerical authorities. They think that because the messages are communicated by these clerical authorities who claim to speak for the Divine, their actions are justifiable and reasonable. They see nothing wrong in causing pain and suffering to innocent people.

Bruce Hoffman also writes about how religious and secular terrorists differ in their constituencies. Where secular terrorists attempt to appeal to a constituency that is composed of actual and potential sympathisers and members of the communities that they purport to defend or protect, or the aggrieved people for whom they claim to speak, religious terrorists seek to appeal to no other constituency than themselves. Moreover, this absence of a constituency leads to a sanctioning of almost limitless violence against a virtually open- ended category of targets; that is, anyone who is not a member of the terrorists' religion or religious sect. So it can be said that their constituency consists of members of their religious community and supporters of their religion only.

Religious and secular terrorists also have starkly different perceptions of themselves and their violent acts. Where secular terrorists regard violence either as a way of instigating the correction of a flaw in a system that is basically good or as a means to provoke to create a new system, religious terrorists see themselves not as components of a system worth preserving but as 'outsiders', seeking fundamental changes in the existing order. This sense of alienation also enables the religious terrorist to contemplate far more destructive and deadly types of terrorist operations than secular terrorists and a reason to have a far more open -ended category of 'enemies' for attack.

Although the purpose differs, both religious terrorism and secular terrorism use violence to

solve their problem and bring the society great panic. They seek to achieve change by the public impact of violence. The religious terrorism and secular terrorism are always unpredictable. When and where will the terrorist activities occur? What are their aims? All of these issues are unknown until the terrorist events happen. This unpredictability makes terrorism more difficult and traumatic to deal with. Also, the victims of religious terrorism and secular terrorism have a symbolic meaning. The potential victims of terrorist attacks are not really randomly selected. These targets are the symbol of what the terrorists want to attack because of their status, their location or their activities.

It is the ignorance and misinterpretation of religion that allows terrorists to find a way to legitimise their acts of terror. Terrorism is a natural supporter of violence. Devout followers who turn into terrorists are often misled by some priests who knowingly or unknowingly misconstrue words written in the Holy Book. These wrong teachings make them believe that people belonging to certain other religions or those who worship different Gods are sinners or wrong-doers. These followers believed that violence is an expression of worship and that they were taking away the sinners in accordance with the will of God by committing heinous crimes. Therefore, they do not feel guilty for the murder of innocent people or the harm done to public property or the resultant wastage of resources. They also believe that their actions are permissible by their religion and consider them to be sacred. Compared with the other types of terrorism, their so-called "enemy" is broader and numerous because it includes the entire populace except their own religious community. This fact deems religious terrorism as bloodier than the other types of terrorism.

Terrorism does not occur without reason and no person is born a terrorist. So why does terrorism happen? The answer to this question is answered by Osho in his audio book titled 'Beyond Psychology'[2]. In it he says that man needs a war every ten to twelve years because the anger and violence that he accumulates needs to be released. Until the basic grounds of humanity are changed, terrorism is going to become more and more a normal, everyday affair. It will happen in the airplanes, it will happen in the buses. It will start happening in the cars. According to Osho, it is all the religions who are the real criminals, because they have destroyed all possibilities of rejoicing. But then communism came – a materialist religion – which provoked people and said to them, 'Your old religions are all opium to the people, and it is not because of your evil actions in this life or in past lives that you are suffering poverty. It is because of the evil exploitation of the bourgeois, the super-rich that you are suffering. The last sentence in Karl Marx's Communist Manifesto is: 'Proletariats of the whole world unite; you have nothing to lose and you have the whole world to gain. You are already poor, hungry and naked – so what can you lose? Your death will not make you more miserable than your life is making you. So why not take a chance and destroy those people who have taken everything away from you. And take those things back, distribute them.'

People who turn to terrorism usually come from weak financial backgrounds. They are the ones who have been exploited. The ones who have been denied some of the basic requirements that the fortunate take for granted. That is why the masterminds of the terrorist attacks find it is easy to lure such people into their mission with the promise of heavy monetary rewards and revenge against those who they deem responsible for their misery. Their lack of quality education and moral guidance also makes it easy to misguide them and involve them in terrorist activities.

Reverence to their religion is their spiritual motivation of carrying out terrorist attacks, but not the root cause of terrorism. Like most people, these people had lived quietly in the world in which many religions exist. They sheltered their

2. Osho "Beyond Psychology", Talk #18 – Terrorism is in Your Unconscious

religion carefully, but their religion gradually declined under the impact of Western culture. These desperate followers feel the need to take extreme violent methods to eradicate those who threaten their religious beliefs when it seems that those numerous religions may dissolve their faith. Their experiences in real-life, including the intense power that Western countries wield over the political, economic and social conditions in other countries of the world, economic sanctions, military strikes, make them feel that they are victims and that they have the right to retaliate against the people who bring them religious insecurity.

Boko Haram was identified to be the most deadly terrorist group in the world with 6,644 deaths attributed to it in 2014 followed by ISIL being responsible for 6,073 terrorist deaths.

Fifty one per cent of terrorist deaths that are attributed to a terrorist group were by Boko Haram and ISIL.[3]

Boko Haram is an Islamic militant group active in Nigeria. Nigeria has experienced the largest increase in deaths from terrorism in 2014 and this increase is a result of the presence of Boko Haram and the Fulani militants. Boko Haram has caused havoc in Africa through a wave of bombings, assassinations and abductions and is fighting to overthrow the Government and establish an Islamic state. It is a branch of the ISIL.

The Islamic State of Iraq and Levant (ISIL) is a powerful terrorist organisation; strong enough to rout several divisions of a national army, and rich enough to sustain their operations at an impressive pace. It has been responsible for some of the blood–curling attacks and beheading incidents.

Other deadly terrorist groups include the Taliban, al-Qaeda and Klu Klax Klan, among countless others.

The Taliban is a militant Islamic movement that emerged in reaction to the lawlessness caused by infighting between rival mujahideen forces in the wake of the Soviet withdrawal in 1989. The Taliban's declared aims included the restoration of peace, rigid enforcement of Islamic law, disarming the population, and defending the Islamic character of Afghanistan. The Taliban set out to create the world's most pure Islamic regime by introducing a disturbing and deeply revolutionary form of Muslim culture that came at a tremendous cost to human freedom.

Founded by Osama Bin Laden and other militants, the al-Qaeda's objective is to unite the Muslims across the world in global jihad and a strict interpretation of the Sharia law. The al-Qaeda had a role to play in the September 11 attacks, the 1998 US embassy bombings and the 2002 Bali bombings. Although the death of Osama Bin Laden has proven to be a setback to their operations, they are still the deadliest among all such groups in the world. Their characteristic way of carrying out missions is to employ suicide bombers or execute suicide missions. Their attacks are also known to be sectarian in nature. The Ashoura massacre and the April 2007 Baghdad bombings are testimony to that fact. The 1993 bombing of the World Trade Center was also carried out by Al-Qaeda.

Since its creation after the American Civil War, the Ku Klux Klan has been terrorising Americans in the name of Protestantism and racial purity. Known for their terrifying costumes and hoods, they have wrought fear and violence against blacks, Jews, immigrants, gays, and Catholics for hundreds of years, responsible for countless massacres, lynchings, rapes, and bombings that have killed thousands. In the modern day, it still has a membership of 5,000 to 8,000 terrorists that operate in individual chapters.

The word terrorism is usually associated with Islam. But it is unfair to associate terrorism with Islam as terrorism is a global issue and all Muslims are not terrorists as has been rightly depicted in the dialogue 'My name is Khan and I'm not a terrorist' of the movie My Name is Khan. People are suffering from Islamophobia because of the rising instances of terrorist groups

3. Global Terrorism Index, 2015

who aim to establish Islamic states in different parts of the world.

An example of this would be the infamous Wisconsin Sikh Temple massacre that took place on August 5, 2012. The virulent Islamophobia that has plagued America post the 9/11 World Trade Center attacks has not only posed a threat to Muslims but it has had deadly consequences for people of other faiths, including Sikhs. The traditional Sikh attire, including their turbans, is different from traditional Sunni, Shiite or Sufi attire. But to a racist, a bearded Sikh looks like a Muslim. Only four days after 9/11, Balbir Singh Sodhi, a Sikh immigrant from India who owned a gas station in Mesa, Arizona was murdered by Frank Silva Roque, a racist who obviously mistook him for a Muslim. But Sodhi's murder was not the last example of anti-Sikh violence in post - 9/11 America. On August 5, 2012 a white supremacist Wade Michael Page used a semi-automatic weapon to murder six people during an attack on a Sikh temple in Oak Creek, Wisconsin. Page's connection to the white supremacist movement was well-documented: he had been a member of the neo-Nazi rock bands End Empathy and Definite Hate. Attorney General Eric Holder described the attack as "an act of terrorism, an act of hatred." Another example is that of the Chechen brothers, Dzhokhar Anzorovich Tsarnaev and the late Tamerlan Anzorovich Tsarnaev who were the masterminds behind the Boston Marathon bombing of April 15, 2013.

"Religious people today are not following spirituality that is embedded in their religion. This holds true for everybody, in all religions – in Christianity, Islam and also in Judaism," says Sheikh Burhanuddin Herrman, a Sufi mystic of German origin, discussing extreme fundamentalism that threatens humanity. He says, "If you ask about the Islamic community and what is wrong with it, they say – 'there is a Sultan missing'. There have been many years now that we have not had a sultanate. A Sultan has authority over religious interpretation which means that anybody who disagrees on something will have to stand out in front of the Sultan and accept his authority. All these violent movements that we see today will not have his approval. There is no 'jihad' without the approval of the Sultan. So everything is very much connected to that figure. The biggest problem is that Muslims are not thinking about the right and the wrong. Those who are empowered with the power of interpretation for instance, about music or about other things, are mostly uneducated and that is tragic. There isn't any Muslim who I know, at least, in Islamic countries, agrees with ISIS. We don't consider ISIS within Islam. They only deserve the severest of punishment for what they do."[4]

Religious terrorism is based on a concept of God favouring some and being angry with others. This notion undermines the omnipresence and omnipotence of God. How can an omnipresent God exclude some people? How can an omnipotent God be angry? Anger and frustration rises when someone is unable to do or control something. With this limited idea of God, you become the saviour of God rather than the servant of God.

Terrorism fails to recognise that God loves variety and diversity; that many different schools of thought exist in this world. Terrorism does not respect or honour life. Terrorism arises when someone identifies himself first and foremost as a member of any particular religion, and then is ready to give up his life for that limited identity. What we forget is that all of us are created by the same supreme authority. We need to first identify ourselves as part of the Divine and then as human beings.

What is the remedy for terrorism? As long as there is limited understanding, limited wisdom, there is no way we can get rid of terrorism from this world. We have to broaden our vision and educate people in all the different religious and cultural traditions of the world. Multicultural and multi-religious activities are necessary to remove

4. Speaking Tree dated 29-11-2015

prejudices and phobias from young minds. It is absolutely essential that all nations embrace multi-cultural and multireligious educations and celebrate diversity. Religious and spiritual leaders, in particular, should have a broad understanding of cultures and religions. Every mullah, every priest and rabbi should know something about all other religions. If we learn to broaden our vision and deepen our roots, people will not fall into a narrow idea of the will of God.

Terrorists are completely mistaken; they are mistaken about their religious teachings, they have a mistaken idea of freedom, and they are mistaken in what they want to achieve in life because they are inflicting suffering on others and also on themselves. Directing hatred and anger towards terrorists will not change or improve them. We need to bring transformation in them and for that we need patience, endurance, and compassion. The wrong understanding of the verses from scriptures has caused upheaval in the minds of many people and is used to justify narrow-mindedness. That is why we need to emphasise education of people in all the holy scriptures of the world. When we think that only our own scripture holds truth, then we are nurturing fanaticism. Terrorists have a very narrow vision. What is needed is broader vision and deeper roots. This could bring about harmony and a non-violent attitude in all people. The only way to get rid of fanaticism in the world is through education that is broad based, multi-cultural and multi-religious, so that a child growing up does not think that only the Bible or only the Quran or the Bhagavad Gita holds the truth. All religions emphasise the principles of non-violence, peaceful co-existence and values of friendliness, compassion and service to society. These common principles need to be highlighted and introduced early on in a child's education. Even a small section of people with prejudices and misconceptions can prove dangerous to society.

We have to value all human life, value it more than race, religion and culture. It is important to honour the values that are found in all religions. If a person identifies himself with a race or religion, culture or nationality, he remains in that position and he will fight for that and die for that and others will die with him. If one identifies oneself with a religion as a priority, forgetting that first he is a reflection of God and that he is a human being then misery is brought on all humanity. When a sense of connectedness is present, one cannot harbour hatred for others.

Unfortunately, in every religion today, there are people who are narrow-minded and thrive on creating phobia, prejudice and erroneous perceptions about other cultures and religions. Closed mindsets, limited interactions, and a sense of disconnectedness with other cultures and communities can lead to situations that can spark such violent acts. We accept food, art and music from around the world. In the same way, we need to learn to accept knowledge and wisdom from every part of the world as well. We live in an age of globalisation. We need to globalise wisdom also. Even if one part of the world lacks these human values of friendliness, tolerance and compassion, the world will not be a safe place because that part can breed terrorism.

Spiritual education is crucial to help individuals deal with anger and hatred. Without a means to control them, anger and hatred can lead to a situation where one loses sight of reason. When the ability to reason is lost, human values of tolerance and compassion are lost. Respect for life, which is the basis for all human values, is also lost as a result.

Terrorists have no respect for life. In reality, terrorists have no religion, no nationality and no philosophy, for they are blind to reason. When a person is frustrated, angry or hateful, you cannot expect brotherhood and non-violence to prevail. The sense of connectedness in society depends on how people are oriented to the principle of Ahimsa or non-violence. If the values of non-violence, love, friendliness and compassion are strongly ingrained in an individual, frustration or disappointments can be handled better.

The Dalai Lama, winner of the Nobel Peace Prize in 1989, has long advocated non-violence in conflicts across the world, including in his homeland of Tibet. He wrote after the 9/11 attacks:

"Terrorism cannot be overcome by the use of force because it does not address the complex underlying problems. In fact the use of force may not only fail to solve the problems, it may exacerbate them and will most likely leave destruction and suffering in its wake. Human conflicts should be resolved with compassion. The key is non-violence. Retaliatory military action by the United States may bring some satisfaction and short-term results but it will not root out the problem of terrorism. Long-term measures need to be taken. The US must examine the factors that breed and give rise to terrorism. I have written to President Bush urging him to exercise restraint and not to seek a brutal revenge for the 11th September attacks. I expressed my sympathy but I suggested that responding to violence with more violence might not be the answer. I would also like to point out that to talk of non-violence when things are going smoothly is not of much relevance. It is precisely when things become really difficult, urgent and critical that we should think and act non-violently."

When people become utterly blinded by their beliefs, then instead of offering or seeking solutions, they see destruction as the only way. For them, violence is not a means to an end but violence is the means and the end.

Human values are social and ethical norms common to all cultures and societies, as well as religions. They represent a melding of social progress and spiritual growth. When attention is given to the spiritual aspect of one's life, it brings up responsibility, a sense of connectedness, compassion and caring for the whole of humanity. Spirituality upholds and sustains life. It breaks down the narrow boundaries of caste, creed, religion and nationality. Spirituality gives an individual awareness of the life present everywhere. It is only through this awareness and the uplifting of human consciousness that violence in the name of religion can be eliminated.

Dalai Lama's following statement provides a solution to this global issue of terrorism. He says,

"People want to lead peaceful lives. The terrorists are short-sighted, and this is one of the causes of rampant suicide bombings. We cannot solve this problem only through prayers. I am a Buddhist and I believe in praying. But humans have created this problem, and now we are asking God to solve it. It is illogical. God would say, solve it yourself because you created it in the first place. We need a systematic approach to foster humanistic values, of oneness and harmony. If we start doing it now, there is hope that this century will be different from the previous one. It is in everybody's interest. So let us work for peace within our families and society, and not expect help from God, Buddha or the governments."

The fight against terrorism is ours to win. But it will only be possible if every citizen of the world takes up the responsibility to promote religious tolerance and reduce the boundaries between religions that have been created by no one but man himself. When this is achieved, people will have learnt to live in peace with themselves and others and the dream of a happy and harmonious world will no longer seem utopian.

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DIRECT TAXES
Supreme Court

SLP granted against the decision of the Bombay High Court in a case where the assessee, a Mauritius based telecaster of TV channels, carried out entire activities from Mauritius and its affiliates/agents in India were remunerated on arm's length basis for carrying out only routine functions in India, they did not constitute assessee's PE in India

DIT vs. B4U International Holdings Ltd. LP (Civil) No. 10482/2016, dated 1st July, 2016

The assessee, a Mauritius company, was in the business of telecasting of television channels. During the relevant assessment year, the assessee had revenue from India consisting of collections from time-slots given to advertisers from India. The Reserve Bank of India granted general permission to B4U and B4U India to act as advertisement collecting agents of the assessee. The assessee claimed that it did not have a permanent establishment in India, and therefore it was not liable to tax in India under Article 7 of the DTAA between India and Mauritius. The assessee further contended that its agents had marked the advertisement time slots of the channels broadcasted by the assessee for which they had received remuneration on the arm's length basis. Thus, in the light of the Central Board of Direct Taxes Circular No. 23 of 1969, the income of the assessee was not taxable in India. The conditions of the circular were fulfilled. Therefore, Explanation 1(a) to section 9(1)(i) of the Income-tax Act, 1961, would have no application. The Assessing Officer did not accept the contentions of the assessee but the Tribunal relied on Article 5(5) of the DTAA and noted the findings of the Assessing Officer and found that the Commissioner (Appeals) held that the assessee carried out the entire activities from Mauritius and all the contracts were concluded in Mauritius. The only activity which was carried out in India was incidental or auxiliary/preparatory in nature which was carried out in a routine manner under the direction of the principal without application of mind and, hence, B4U India was not a dependent agent. Nearly 4.69 per cent of the total income of B4U India was commission/service income received from the assessee and, therefore, also it could not be termed as a dependent agent. As far as the alternative contentions were concerned, the Commissioner (Appeals) held that the assessee and B4U were dealing with each other on arm's length basis. Fifteen per cent fee was supported by Circular No. 742. Thus, he held that no further profits should be taxed in the hands of the assessee. This

conclusion of the Commissioner (Appeals) was upheld by the Tribunal. The Tribunal concluded after referring to the clauses in the agreement between the assessee and B4U that B4U India was not a decision-maker nor had it the authority to conclude contracts. Further, the Revenue had not brought anything on record to prove before the Tribunal that the agent had such powers and from the agreement any such conclusion could not have been drawn. Barring this agreement, there was no material or evidence with the Assessing Officer to disprove the claim of the assessee that the agent had no power to conclude the contract. Thereafter, the Tribunal referred to the DTAA and particularly Articles 5(4) and (5) and concluded that the requirement that the first enterprise in the first mentioned State had and habitually exercised in that State an authority to conclude contracts in the name of the enterprise unless his activities are limited to the purchase of goods or merchandise for the enterprise was not satisfied.

The Bombay High Court dismissed the appeal and held that the Tribunal's order did not raise any substantial questions of law. The alternative contention of the assessee was that assuming that B4U India was a dependent agent of the assessee in India it had been remunerated at the arm's length price and, therefore, no profits could be attributed to the assessee. The Tribunal had rightly dealt with the alternative argument referring to Circular No. 742. There, 15 per cent was taken to be the basis for the arm's length price. Nothing contrary having been brought on record by the Revenue before the Commissioner (Appeals) as also the Tribunal, the income of the assessee was not liable to tax in India. (374 ITR 453, Bom.)

The SLP is granted by the Supreme Court against the aforesaid decision of the Bombay High Court.

SLP granted against the decision of the High Court that mere existence of an agreement whereby a license has been granted to assessee to use brand name would not *ipso facto* imply any further understanding or arrangement between assessee and its foreign AE regarding AMP expense for promoting brand of foreign AR to infer an international transaction

DCIT vs. Honda Siel Power Products Ltd. SLP (Civil) No. 10482/2016, dated 1st July, 2016)

1. The TPO benchmarked AMP expenses by applying the Bright Line Test ('BLT'), and compared the percentage of such expenses incurred to total sales of the assessee with that of comparable companies. As the AMP expenses of the assessee as a percentage of sales was higher than that incurred by the comparable companies, the TPO concluded that the AMP expenses incurred by the assessee, in excess of the Bright Line must be regarded as having been incurred for promoting the brand name HONDA and further that this was for creating marketing intangibles owned by the AE for which the assessee was required to be suitably compensated by the AE. The TPO determined the ALP of the assessee's international transactions with respect to AMP expenses. He further charged a mark-up of 15 per cent and accordingly made a transfer pricing adjustment on account of AMP expenses.

2. The Delhi High Court held as under:

"37. Additionally, it was held both in *Maruti Suzuki India Ltd. (supra)* as well as *Whirlpool of India Ltd. (supra)* that in terms of the law explained by the Supreme Court in *CIT vs. B.C. Srinivas Setty [1981] 128 ITR 294/5 Taxman 1* and *PNB Finance Ltd. vs. CIT [2008] 307 ITR 75/175 Taxman 242 (SC),* in the absence of any machinery provision, bringing

an imagined international transaction to tax is fraught with the danger of invalidation. In the present case, in the absence of there being an international transaction involving AMP spend with an ascertainable price, even if such price were to be nil, neither the substantive nor the machinery provision of Chapter X are applicable to the transfer pricing adjustment exercise."

"41. In that view of the matter, the question of a benchmarking analysis by evaluating the AMP expenses incurred by the assessee in relation to its total sales vis-à-vis its comparables is not called for. There is nothing to indicate that the AMP expenses incurred by the assessee is at the instance of foreign AE and that the assessee has to be compensated by the foreign AE in that behalf.

"42. Question (ii) is answered in favour of the assessee and against the Revenue by holding that the Revenue has not been able to demonstrate that there exists an international transaction involving the assessee and a foreign AE on the question of AMP expenses." (64 taxmann.com 328, Delhi)

The SLP is granted by the Supreme Court against the aforesaid decision of the Delhi High Court.

Power of the High Court to recall its order

CIT vs. Subrata Roy SLP (Civil) No. 23054/2014, dated 4th July, 2016

The High Court in a common order dated 21st February, 2014 recalled its final order dated 27th August, 2013 passed in Income Tax Appeal Nos. 59/2006, 57/2006, 58/2006, 60/2006, 61/2006 and 62/2006. The question before the Supreme Court was whether the High Court had jurisdiction under Order XLI Rule 21 of the CPC to recall its order passed in an appeal not being an ex parte order.

The Supreme Court held as under:

"7 ..... The question is one of availability of jurisdiction under Order XLI rule 21 of the CPC, namely, that the order passed in the appeal is an ex parte order. Not only the said order dated 27th August, 2013 is not an ex parte order as contemplated by the provisions of the Code of Civil Procedure, 1908, the final order dated 27th August, 2013 passed by the High Court clearly contains findings (extracted above) which is to the contrary. In these circumstances, we are of the view that the High Court did not have the jurisdiction under Order XLI, Rule 21 CPC to recall the final order dated 27th August, 2013 passed in the Income Tax Appeals. The power available under Order XLI, Rule 21 is hedged by certain pre-conditions and unless the pre-conditions are satisfied the power thereunder cannot be exercised."

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Jitendra Singh & Sameer Dalal
Advocates

DIRECT TAXES
Tribunal

REPORTED

1. Deduction of TDS – Section 194C or Section 194J of the Income-tax Act, 1961 – Payment made to gazal group for live performance which has not been captured – will not come within the ambit of rendering of any 'professional services' – Hence, TDS is not required to be deducted under section 194C and not under section 194. A.Ys.: 2006-07 & 2007-08

C. J. International Hotels Ltd. vs. ACIT [2016] 158 ITD 287 (Delhi)

The assessee is engaged in the business of running a hotel. It made payment to gazal singer for live performance in its hotel and deducted TDS under section 194C. The A.O. finalised the assessment by observing that tax ought to have been deducted under section 194J. It, therefore, treated the assessee as assessee-in-default and levied interest under section 201(1) of the Act. On appeal the First Appellate Authority upheld the action of A. O. The assessee being aggrieved by the order passed learned. CIT(A) preferred an appeal before the Hon'ble Delhi Appellate Tribunal. The Appellate Tribunal was pleased to allow the appeal of the assessee by observing that where a singer rendered live performance in assessee's hotel which did not result in production of cinematograph film, deduction of TDS under section 194C was justified.

2. Cancellation of registration – Section 12AA of the Income-tax Act, 1961 – Mere non-intimation of amendments in Trust deed to Department cannot *ipso facto* lead to cancellation of registration. A.Y.: 2009-10

ITO vs. Bhansali Trust [2016] 137 DTR (Mumbai)(Trib.) 336

The assessee before the Appellate Tribunal is a Trust registered under section 12A of the Act and is carrying out charitable activities for more than 40 years. During the relevant assessment year the assessee claimed exemption under sections 11/12 of the Act. The A.O. however finalised the assessment denying the exemption claimed by the assessee and determining total income at ` 16,46,14,071/- on the ground that the

objects of the assessee Trust have been amended after the grant of Registration under section 12A of the Act and the assessee is required to get re-registered with the Director of Income Tax (Exemption) under section 12A of the Act after such amendments in the objects. On appeal the First Appellate Authority deleted the addition made by A.O. and allowed the claim of exemption under sections 11/12 of the Act. The Department being aggrieved by the above order preferred an appeal before the Hon'ble Mumbai Appellate Tribunal. The Tribunal upheld the order of the learned CIT(A) and dismissed the appeal of the Department by observing that mere non-intimation of amendments in Trust deed to Department cannot *ipso facto* lead to cancellation of registration because statutory requirement contained in section 12AA(3) prescribes that cancellation of registration cannot be effectuated unless a case is made out that new objects do not fit in with existing objects, i.e., new objects are 'non-charitable' in nature, or that activities are ungenuine.

3. Deduction under section 80-IC of the Income-tax Act, 1961 – conversion of raw material into article as per the direction of the customers – amounts to manufacture or production – deduction under section 80-IC cannot be denied. A.Y.: 2010-11

ITO vs. Bhansali Trust [2016] 137 DTR (Mumbai)(Trib.) 336

The assessee before the Appellate Tribunal is a firm engaged in the business of assembling and undertaking civil contracts for and on behalf of Government and public sector undertaking. The assessee in its return of income claimed deduction under section 80-IC of the Act. The A.O. however while finalising the assessment denied the deduction claimed under section 80-IC of the Act on the ground that assessee had not explained about the article or things manufactured and manufacturing process. On appeal the First Appellate Authority upheld the order of the A.O. The assessee being aggrieved by the order passed by learned CIT(A) preferred an appeal before the Hon'ble Delhi Appellate Tribunal. The Appellate Tribunal was pleased to allow the claim of the assessee by observing that the assessee being engaged in carrying out the process of procurement, fabrication and installation of the retail visual identity whereby the raw material is fabricated in a manner so as to create an article which is of use to assessee's customers as per their specifications. Hence, the activity carried out by the assessee amounts to manufacture or production. Thus, the assessee is entitled to deduction under section 80-IC of the Act.

UNREPORTED

4. Deduction under section 54 of the Income-tax Act, 1961 – year of taxation of capital gains - agreement to sell entered on 7-1-2011 having clause of handing over the possession in next 10/30 days – actual possession granted on 14-5-2011 with mutual consent between the parties – capital gains liable to be taxed in the year 2012-13 and deduction under section 54 is allowable in the year 2012-13. A.Y. 2011-12

Shri Javed K. Khan vs. Income Tax Officer [ITA No. 98/Mum/2015 order dated 22-7-2016]

The assessee before the Hon'ble Appellate Tribunal is an individual. Assessee's father Mr. Karmaruzzama Ghasi Khan was occupying one flat 9/B, 3rd Floor, in Ann Ville as a tenant. On 16-4-2008, he entered into an agreement with the owners of the flat by giving up the tenancy rights and by paying a sum of ` 33,798/-, he became the owner of the flat. On 29-4-2008 assessee's father executed a gift deed, gifting this flat to assessee and this Gift Deed was registered on 30-4-2008. On 7-1-2011, assessee entered into an agreement for sale of this flat for a total consideration of ` 70.00 lakh but whose market value as per Stamp Duty rates was at ` 1,15,87,600/-. The assessee purchased a new flat No. B/103, Pioneer Heritage Residency at Daulat Nagar, Santacruz on 19-1-2011 for a sum of ` 85,00,000/-. The A.O. during the course of assessment proceedings noticed that the assessee has not disclosed any income under the head capital gains or particulars of deduction claimed under section 54 of the Act. The A.O. noted the fact that the agreement for purchase of the flat was entered into by assessee's father on 16-4-2008 for a sum of ` 33,798/- and this was gifted to the assessee by his father on 29-4-2008. This flat was sold by assessee on 7-1-2011 i.e., within 32nd month and accordingly this is a short term capital gain. Thus, the A.O. has made addition under the head short term capital gain on the sale of impugned flat and denied any deduction under section 54 of the Act. The assessee being aggrieved by the above assessment order preferred an appeal before the First Appellate Authority. The learned CIT(A) upheld the action of the A.O. in making the addition. The assessee being aggrieved by the order passed by learned CIT(A) preferred an appeal before the Hon'ble Mumbai Appellate Tribunal. Before the Appellate Tribunal the assessee raised an additional ground that the capital gains is not chargeable in the impugned assessment year as the possession of the flat is given only in subsequent assessment year. The Appellate Tribunal was pleased to allow the claim of the assessee by observing that the assessee, who entered into agreement to sell dated 7-1-2011 and in this agreement a specifically mentioned Clause 2(b) states that the possession of the flat was to be given to the purchaser in the next 10/30 days and eventually the possession of the said flat was granted on 14-5-2011 with the mutual consent. Reckoned from the date of possession i.e., 14-5-2011 the assessee is entitled for treatment of sale of flat as long term and capital gain will be treated as long term capital gain because the property was acquired by assessee's father on 16-4-2008 and assessee handed over the possession to the purchaser only on 14-5-2011, it means the holding period is more than thirty six months. The assessee has invested a sum of ` 89,22,500/- in purchase of new flat, the proceeds out of sale of the flat. In our view the assessee is entitled for deduction under section 54 of the Act and assessment of this transaction is to be made in assessment year 2012-13 and not in assessment year 2011-12.

> Those who cannot work with their hearts achieve but a hollow, half-hearted success that breeds bitterness all around.
>
> *— Dr. A. P. J. Abdul Kalam*

CA Sunil K. Jain

DIRECT TAXES

Statutes, Circulars & Notifications

NOTIFICATIONS

Section 200, read with section 206C, of the Income-tax Act, 1961 – Deduction of Tax at Source – Duty of person deducting tax – Procedure for online submission of statement of deduction of tax under section 200(3) and statement of collection of tax under proviso to section 206C(3)

The Principal Director General of Income-tax (Systems) laid down the procedures of registration in the e-filing portal, the manner of the preparation of the statements and submission of the statements. Once uploaded as per the procedure, the status of the statement shall be shown as "Uploaded". The uploaded file shall be processed and validated. Upon validation, the status shall be shown as either "Accepted" or "Rejected which will reflect within 24 hours from the time of upload. The status of uploaded file is visible at TDS -> View Filed TDS. In case the submitted file is "Rejected", the rejection reason shall be displayed.

(Notification No. 11/2016 Notification/106/2016], dated 22-6-2016)

Income-tax (Sixteenth Amendment) Rules, 2016 – Amendment in Rule 10U

As per section 101, and rule 10U regarding change of dates for Application of General Anti Avoidance Rule the Central Board of Direct Taxes made the rules as the Income-tax (16th Amendment) Rules, 2016 which shall come into force from the date of their publication in the Official Gazette.

(Notification No. dated 22-6-2016)

Section 10(23EE) of the Income-tax Act, 1961 – Exemption – Core Settlement Guarantee Fund – Notified Fund

The Central Government notified the Core Settlement Guarantee Fund, set up by Indian Clearing Corporation Limited (ICCL), Mumbai, and National Securities Clearing Corporation Limited (NSCCL), Mumbai, a recognised clearing corporation, for the purposes of the aforesaid clause, for the assessment year 2016-17 and subsequent assessment years.

(Notification Nos. 50-51 / 2016 dated 23-6-2016)

Section 197A, read with sections 10(23D), 115TC and 194A, of the Income-tax Act, 1961 – Deduction of Tax at Source – No deduction in certain cases – Notified payments – Corrigendum to Notification No. SO

2142(e) [No.46/2016 (F.No.275/16/2016-IT(b))], dated 17-6-2016

(Notification No.52/2016 - dated 23-6-2016)

Income-tax (Seventeenth Amendment) Rules, 2016 – Insertion of Rule 37BC and amendment in Form No. 27Q

As per clause (ii) of sub-section (7) of section 206AA, read with section 295 of the Income-tax Act, the Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962, called the Income-tax (17th Amendment) Rules, 2016 which shall come into force on the date of their publication in the Official Gazette. In the Income-tax Rules, 1962 after rule 37BB, the rule 37BC as Relaxation from deduction of tax at higher rate under section 206AA(1) in the case of a non-resident, has been inserted.

(Notification No.53/2016 - dated 24-6-2016)

Income-tax (Eighteenth Amendment) Rules, 2016 – Insertion of Rule 128 and Form No. 67

The Central Board of Direct Taxes made the rules further to amend the Income-tax Rules which may be called the Income-tax (18th Amendment) Rules, 2016 and shall come into force on the 1st day of April, 2017. In the said Rules, 1962 after rule 127, rule 128 for Foreign Tax Credit has been inserted.

(Notification No.54/2016 – dated 27-6-2016)

Section 219 of the Finance Act, 2016 – Commencement and Amendment of Act No.2 of 1934 – Notified date on which provisions of Part I of Chapter XII of said Act shall come into force

As section 219 of the Finance Act, 2016, the Central Government appointed the 27th day of June, 2016, as the date on which the provisions of Part I of Chapter XII of the said Act shall come into force.

(Notification No. SO 2214(E) [F.No.12/1/2016-FSLRC (i)], dated 27-6-2016)

Income-tax (Nineteenth Amendment) Rules, 2016 – Insertion of Rules 11UB, 11UC, 114DB, and Form No. 3CT, Form No. 49D

As per section 9 and section 285A the Central Board of Direct Taxes made the rules further to amend the Income-tax Rules, 1962, which may be called the Income-tax (19th Amendment), Rules, 2016 and shall come into force on the date of their publication in the Official Gazette. In the Income-tax Rules, 1962 (hereinafter referred to as the said rules), in Part II, after sub-part H, the sub-part has been inserted, as "I- Determination of value of assets and apportionment of income in certain cases *vide* rule 11UB for Fair market value of assets in certain cases; 11UC. Determination of Income attributable to assets in India; "Form No. 3CT and “Form No. 49D under Rule 114DB have been inserted.

(Notification No.55/2016 – dated 28-6-2016

Section 138 of the Income-tax Act, 1961, read with Income Declaration Scheme, 2016 – Income-tax Authorities – Information respecting assessee, disclosure of – No disclosure of information by public servants in respect of a valid declaration made under Income Declaration Scheme, 2016

As per sub-section (2) of section 138 of the Income-tax Act, the Central Government having regard to all the relevant factors, directed that no public servant shall produce before any person or authority any such document or record or any information or computerised data or part thereof as comes into his possession during the discharge of official duties in respect of a valid declaration made under 'the Income Declaration Scheme, 2016', contained in Chapter IX of the Finance Act, 2016.

(Notification No. SO 2322(E) [F.No.142/8/2016-TPL], dated 6-7-2016)

Authority for Advance Rulings (Terms and Conditions of Service and Salaries and Allowances of Chairman, Vice-Chairman and Members) Rules, 2016

As per sub-section (4) of section 245-O of the Income-tax Act, 1961 (43 of 1961) and in supersession of Authority for Advance Rulings (Salaries and Allowances, Terms and Conditions of Service of Chairman, Vice-Chairman and Members) Rules, 1994, except as respects things done or omitted to be done before such supersession, the Central Government made the rules, regulating the terms and conditions of service and salaries and allowances of the Chairman, Vice-Chairman and Members of the Authority for Advance Rulings.

(Notification No. GSR 674(E) [F.No.Q-29016/2/2015-AD.1C (AAR)], dated 8-7-2016)

Section 35AC of the Income-tax Act, 1961 – Eligible projects or Schemes, expenditure on – Notified eligible projects or schemes

As per sub-section (1) read with clause (b) of the Explanation to Section 35AC of the Income-tax Act, the Central Government, on the recommendation of the National Committee for Promotion of Social and Economic Welfare, notified the institutions approved by the said National Committee, and approves the eligible projects or schemes specified to be carried on by the said institutions and the estimated cost thereof and also specified the maximum amount of such cost which may be allowed as deduction under the said section 35AC for the period of approval.

This notification shall remain in force for the period of and in relation to financial year in respect of the projects or schemes mentioned against the respective institutions/projects. The exemption u/s. 35AC will not apply to the funds received under Schedule VII of the Section 135 of the Companies Act and Companies (CSR) Rules, 2014.

(Notification No.59/2016 - dated 12-7-2016)

Section 92C of the Income-tax Act, 1961 – Transfer Pricing – Computation of Arm's Length Price – Notified tolerance limit under third proviso to sub-section (2) of section 92C for Assessment Year 2016-17

As per the third proviso to sub-section (2) of section 92C of the Income-tax Act, read with proviso to sub-rule (7) of rule 10CA of the Income-tax Rules, the Central Government notified that where the variation between the arm's length price determined under section 92C and the price at which the international transaction or specified domestic transaction has actually been undertaken does not exceed one per cent of the latter in respect of wholesale trading and three per cent of the latter in all other cases, the price at which the international transaction or specified domestic transaction has actually been undertaken shall be deemed to be the arm's length price for Assessment Year 2016-17.

For the purposes of this notification, "wholesale trading" means an international transaction or specified domestic transaction of trading in goods, which fulfils the following conditions: (i) purchase cost of finished goods is eighty per cent or more of the total cost pertaining to such trading activities; and (ii) average monthly closing inventory of such goods is ten per cent or less of sales pertaining to such trading activities.

(Notification No.57/2016 (F.No.500/1/2014-APA-II], dated 14-7-2016)

Section 183, read with sections 187 and 190 of the Finance Act, 2016 – Undisclosed income – Declaration of – Notified date for specified sections of said Act – Amendment in Notification No.SO 1830(e) [No.32/2016 (F.No.142/8/2016-TPL)], dated 19-5-2016

As per section 187 of the Finance Act, 2016, the Central Government amended the notification of the Ministry of Finance (Department of Revenue), dated the 19th May, 2016 wherein for clause (ii), the following clause has been substituted, "(ii) the date on or before which the tax and surcharge is payable under section 184, and the penalty is payable under section 185 in respect of undisclosed income shall be as follows, (a) the 30th day of November, 2016, for an amount not less than twenty-five per cent of such tax, surcharge and penalty; (b) the 31st day of March, 2017, for an amount not less than fifty per cent of such tax, surcharge and penalty as reduced by the amount paid under clause (a); (c) the 30th day of September, 2017, for the whole amount payable under sections 184 and 185 as reduced by the amounts paid under clauses (a) and (b)".

Notification No. SO 2476(E) [No.59/2016 (F.No.142/8/2016-TPL)], dated 20-7-2016

Income Declaration Scheme, (Amendment) Rules, 2016 – Amendment in Form-1

As per sub-section (1) and sub-section (2) of section 199 of the Finance Act, 2016 the Central Board of Direct Taxes, made the rules further to amend the Income Declaration Scheme Rules, 2016 called as the Income Declaration Scheme, (Amendment) Rules, 2016 which shall come into force from the date of their publication in the Official Gazette. 2. In the principal rules, in Form-1, for serial numbers 1 and 2 and entries relating Name and address of the declarant and Filing status etc. have been substituted.

(Notification No.60/2016 dated 20-7-2016)

Section 32, read with section 32AD of the Income-tax Act, 1961 – Depreciation – Allowance/Rate of – Notified backward areas under first proviso to Section 32(1)(iia) and Section 32AD(1)

As per section 32 and section 32AD of the Income-tax Act the Central Government hereby notified the districts of the States as backward areas under the first proviso to clause (iia) of sub-section (1) of section 32 and sub-section (1) of section 32AD of the said Act.

(Notification No.61/2016 dated 20-7-2016)

CIRCULARS

Section 206C of the Income-tax Act, 1961 – Collection at Source – Profits and Gains from business of trading in alcoholic liquor, forest produce, scrap, etc. – Clarifications on Amendment made by Finance Act, 2016

In order to curb the cash economy, Finance Act, 2016 has amended section 206C of the Income-tax Act to provide that the seller shall collect tax at the rate of one per cent from the purchaser on sale in cash of certain goods or provision of services exceeding two lakh rupees. The Board, has issued FAQs *vide* circular No. 22/2016 dated 8th June, 2016. The Board has further clarified the issue as regards applicability of the provisions relating to levy of TCS where the sale consideration received is partly in cash and partly in cheque by issue of an addendum to the above circular in the form of question and answer as per this circular.

Circular No.23/2016 [F.No.370142/17/2016-TPL], dated 24-6-2016

Section 181 of the Finance Act, 2016 – Income Declaration Scheme Rules, 2016 – Further clarifications thereon

The Income Declaration Scheme, 2016 provides an opportunity to persons who have not paid full taxes in the past to come forward and declare the undisclosed income and pay tax, surcharge and penalty totalling in all 45% of such undisclosed income declared. The Income Declaration Scheme Rules, 2016 have now been notified. In this regard, Circular No. 17 of 2016 dated 20th May, 2016 issued by the Board provided clarifications to 14 queries.

Subsequently, further queries have been received from the public about various provisions of the Scheme. The Board has considered the same and the clarifications issued in this circular.

Circular No. 24 -25 of 2016 – dated 27-6-2016 and 30-6-2016 respectively)

Section 197A, read with section 10(15)(viii), of the Income-tax Act, 1961 – Deduction of Tax at Source – No deduction in certain cases – Clarifications on applicability of section 197a(1d) and section 10(15)(viii) to interest paid by IFSC banking units (IBUS) set up in Special Economic Zones

Section 197A of the Income-tax Act, 1961 provides the circumstances in which deduction of tax at source is not required to be made under Chapter XVII of the Act. Sub-section (1D) of this section provides that deduction is not required to be made by an Offshore Banking Unit on interest paid on deposit made on or after 1-4-2005 by a non-resident or a person not ordinarily resident in India, or on borrowing on or after 1-4-2005 from such persons. Clause (viii) of sub-section (15) of section 10 provides that such interest will not be included in the total income. Offshore Banking Unit is defined in clause (u) of section 2 of the Special Economic Zones Act, 2005 as a branch of a bank located in a Special Economic Zone, which has obtained the permission under clause (a) of sub-section (1) of section 23 of the Banking Regulation Act, 1949.

The board examined and it is observed that IBUs are branches of Indian Banks or Foreign Banks having presence in India, which are established in accordance with the RBI Scheme dated 1-4-2015, in the International Finance Service Centres that are set up in within the Special Economic Zones, as per Section 18 of the Special Economic Zone Act, 2005. Thus, the IBUs fulfil the necessary criteria for being considered Offshore Banking Units as defined in clause (u) of section 2 of the Special Economic Zones Act, 2005. The Board clarified that in accordance with the provisions of section 197A (1D) of the Income-tax Act, 1961, tax is not required to be deducted on interest paid by such IBUs, on deposit made on or after 1-4-2005 by a non-resident or a person who is not ordinarily resident in India, or on borrowings made on or after 1-4-2005 from such persons.

(Circular No.26/2016 [F.No.275/26/2016-IT(B)], dated 4-7-2016)

Section 143 of the Income-tax Act, 1961 – Assessment – General – Issue of notices under section 143(2) in revised format

The Central Board of Direct Taxes, modified notice under section 143(2) of the Income-tax Act. Henceforth, there shall be three formats of the said notice namely:

- Limited Scrutiny – Annex A
- Complete Scrutiny – Annex B
- Manual Scrutiny – Annex C

It is now directed that all scrutiny notices, shall henceforth, be issued in these revised formats. The Systems Directorate is effecting necessary changes in the ITD module in this regard.

Letter [F.No.225/162/2016/ITA.II], dated 11-7-2016

Income Declaration Scheme, 2016 – Further Clarifications on

The Income Declaration Scheme, 2016 came into effect on 1st June, 2016. To address doubts and concerns raised by the stakeholders, the Board has issued three sets of FAQs *vide* Circular Nos. 17, 24 & 25 of 2016. In order to address further queries received from the public relating to the Scheme, clarifications in the form of FAQs have been issued *vide* this circular.

(Circular No.27 of 2016 [F.No.142/8/2016-TPL], dated 14-7-2016)

Finance Act, 2016 – Direct Tax Dispute Resolution Scheme, 2016 – Implementation of

The Direct Tax Dispute Resolution Scheme, 2016 was introduced with effect from 1-6-2016 to address the issue of pending litigation before CsIT(A). Taxpayers stand to benefit by a timely disposal of their litigation, while the Department stands to reduce its administrative cost in disposing appeals and also to collect its due taxes. Therefore, it becomes expedient on the part of all officers to ensure that the Scheme is a resounding success.

On 29-2-2016, there were 73,402 appeals with tax effect above ` 10 lakhs and 1,85,858 appeals with tax effect below ` 10 lakhs pending before CsIT (Appeals). Thus, 2,59,260 appellants are eligible for the benefit of this Scheme. Unlike the Income Tax Disclosure Scheme, 2016, the target audience for this Scheme is limited to the above appellants and their representatives. This relatively smaller target group can easily be approached/informed of the benefits of this Scheme by the Designated Authorities being the PCIT/CIT. Steps have been taken in the matter towards the successful implementation and a Standard Operating Procedure has been introduced.

Letter F.No.279/MISC./M-74/2016-ITJ, dated 19-7-2016

INSTRUCTIONS

Section 143 of the Income-tax Act, 1961 – Assessment – General – Compulsory manual selection of cases for scrutiny during Financial Year 2016-17

The Board hereby laid down the procedure and criteria for manual selection of returns/cases for compulsory scrutiny during the financial year 2016-17. Computer Aided Scrutiny Selection (CASS): Cases are also being selected under CASS-2016 on the basis of broad based selection filters. List of such cases are separately intimated by the Pr.DGIT (Systems) to the jurisdictional authorities concerned.

As a taxpayer friendly measure, to reduce the departmental interface with the assessee and reduce the compliance burden of taxpayers in scrutiny assessment proceedings, the scheme of assessment through e-mail is being extended to all scrutiny cases including the cases selected under above parameters in seven cities of Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata and Mumbai. However, assessees in these seven cities can exercise the option of not being scrutinised under the e-mail based paperless assessment proceedings after informing the Assessing Officer concerned in writing in the beginning or subsequently during the course of assessment proceedings. Further, in cases which require submission of voluminous documents and it is not practicable to submit the scanned copies thereof through e-mail, in such instances, the Assessing Officer may decide to receive such documents in physical form after recording reasons for the same.

In this regard, by 31st January, 2017, concerned authorities have been directed to send a report to the respective Zonal Member with a copy to Member (IT) containing details of at least 25 quality assessment orders from their respective charges. The cases selected for publication in 'Let us Share' are picked up only from the quality assessments as reported.

(Instruction No.4/2016 [F.No.225/176/2016/ITA.II], dated 13-7-2016)

PRESS RELEASES

India and Switzerland agree to move towards an early agreement for implementation of AEOI between two countries

Fighting the menace of Black Money stashed in offshore accounts has been a key priority area for this Government. It is decided that experts of both the countries will meet to further discuss the modalities for the reciprocal bilateral

implementation of AEOI between India and Switzerland that will make possible for India to receive from 2018 financial information of accounts held by Indian residents in Switzerland on automatic basis.

The two sides agreed to pursue the ongoing dialogue on tax and financial matters in a spirit of mutual friendship and co-operation. The text of the 'Joint Statement signed by the two Secretaries at the conclusion of the meeting is part of this press release.

Press Release, Dated 15-6-2016

Section 44AB, read with section 44AD, of the Income-tax Act, 1961 – Audit compulsory – Clarification on threshold limit of tax audit under section 44AB and section 44AD

Section 44AB of the Income-tax Act makes it obligatory for every person carrying on business to get his accounts of any previous year audited if his total sales, turnover or gross receipts exceed one crore rupees. However, if an eligible person opts for presumptive taxation scheme as per section 44AD(1) of the Act, he shall not be required to get his accounts audited if the total turnover or gross receipts of the relevant previous year does not exceed two crore rupees. The higher threshold for non-audit of accounts has been given only to assessees opting for presumptive taxation scheme under section 44AD.

Press Release, dated 20-6-2016

Clarification on news report that Income Tax Department is going to arrest wilful defaulters of tax

Certain sections of the press have been carrying news reports that Income Tax Department is going to arrest wilful defaulters of tax. In this regard, the Board clarified that no such statement has been authorised by the Income-tax Department. Though the provisions for arrest and detention by the Tax Recovery Officers in respect of the non-compliant tax defaulters are contained in the Income-tax Act, these are used extremely sparingly.

Press Release, dated 21-6-2016

Section 90 of the Income-tax Act, 1961 – Double Taxation Agreement – Cabinet approves protocol amending agreement for avoidance of Double Taxation and Prevention of Fiscal Evasion with Belgium

The Cabinet approved the signing of a Protocol amending the Agreement between India and Belgium for avoidance of double taxation and prevention of fiscal evasion with respect to taxes on income. The amendment in the Protocol will broaden the scope of the existing framework of exchange of tax related information between the two countries, which will help curb tax evasion and tax avoidance. The Protocol will also revise the existing treaty provisions on mutual assistance in collection of taxes.

(Press Release, dated 22-6-2016)

Constitution of a Committee to examine desirability and feasibility of having a new financial year

The Government of India has constituted a Committee to examine the desirability and feasibility of having 'a new financial year'. The Committee will examine the merits and demerits of various dates for the commencement of the financial year including the existing date (April to March), taking into account the various relevant factors. The Committee has been given time till 31st December, 2016 to submit its Report.

Press Release, Dated 6-7-2016

Sovereign Gold Bond Scheme, 2016-17

The Reserve Bank of India, has decided to issue fourth tranche of Sovereign Gold Bonds. Applications for the bond will be accepted from July 18, 2016 to July 22, 2016. The Bonds will be issued on August 5, 2016. The Bonds will be sold through banks, Stock Holding Corporation of

India Limited (SHCIL), designated post offices and recognised stock exchanges viz., National Stock Exchange of India Limited and Bombay Stock Exchange. Three tranches of issuances have been undertaken during 2015-16. The features of the Bond are part of this press release.

Press Release : 2016-2017/125, dated 14-7-2016

Section 285A of the Income-tax Act, 1961 – Contractors – Information by, in certain cases – Income Tax Department to issue 7 lakh letters seeking information in respect of high value transactions

Under the Annual Information Returns (AIR), various types of high-value transactions were being reported to the Income Tax Department. These include reporting of cash deposits of ` 10,00,000 or more in a saving bank account, sale/purchase of immovable property valued at ` 30,00,000 or more, etc. Many of these transactions do not have PAN linked to it. The Department has details of about 90 lakh such transactions for the periods 2009-10 to 2016-17. The Income Tax Department has with the help of in-house computer techniques, grouped such non-PAN transactions and identified 7 lakh high-risk clusters having around 14 lakh non-PAN transactions which are being scrutinised by the Income Tax Department closely.

The Department will be issuing letters to the parties of these transactions requesting them to provide their PAN number against these transactions. For the convenience of the parties to whom these letters are addressed, a new functionality on e-filing portal has been developed wherein they can own up transactions and provide structured response electronically. The parties can login to their e-filing website and by quoting a Unique Transaction Sequence Number provided in the letter sent to them, can link their transaction with their PAN easily. They will also be able to give a response to this letter electronically by choosing the option of either owning up the transaction or denying the transaction as their own. The responses received from such parties online will be examined by the Department. The Department will initiate further necessary action in those cases where no replies are received.

The members of public who receive such letters are requested by Board to kindly co-operate in the matter. They may use the Departmental helpline to ask questions, as far as possible, instead of making direct contact with any officials of the Income Tax Department. Members of public are advised not to entertain any claims from unscrupulous elements who may offer their help in complying with such communication by falsely representing themselves to be the agents of Income Tax department in the matter.

(Press Release, dated 21-7-2016)

Section 139A, read with section 203A, of the Income-tax Act, 1961 – Permanent Account Number – Ease of doing business – Paperless PAN & TAN application process

For fast tracking the allotment of PAN and TAN to company applicants, Digital Signature Certificate (DSC) based application procedure has been introduced on the portals of PAN service providers M/s. NSDL eGov and M/s UTIITSL. Under the new process PAN and TAN will be allotted within one day after completion of valid online application. Similarly, a new Aadhaar e-Signature based application process for Individual PAN applicants has been made available on the portals of PAN service providers M/s. NSDL eGov.

The URL links for the above applications are available in 'important links' on the homepage of the departmental website 'incometaxindia.gov.in'.Introduction of Aadhaar based e-Signature through M/s NSDL eGov in PAN application not only ensures paperless hassle free PAN application process but also seeding of Aadhaar in PAN which will curb the problem of duplicate PAN to a great extent.

Press Release, dated 22-7-2016

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INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT JUDGMENTS

1. Large companies, companies engaged in software development programmes, sale, offshore development services, research and development, companies failing the related party filter and companies having extraordinary events could not be compared with the assessee, a captive service provider engaged in providing software development services. Safe Harbour Rules do not have retrospective application

Pr CIT vs. Fiserv India Pvt. Ltd. – TS-437-HC-2016 (Del.) - TP

Facts

(i) The assessee, M/s. Fiserv India P. Ltd., a wholly owned subsidiary of Results International Systems Inc, USA was engaged in the provision of software development and maintenance services to its AEs, for which it was compensated at cost-plus 15 per cent markup. The assessee adopted the Transactional Net Margin Method ('TNMM'), using the operating profit to operating cost filter as the Profit Level Indicator to benchmark its international transactions and arrived at 29 comparable companies, the average PLI of which was 9.54 per cent as opposed to the mark-up of 15 per cent earned by it. Accordingly, it contested that its international transactions were at arm's length price.

(ii) The TPO rejected the TP study of the assessee and carried on a fresh search process, arriving at 13 comparable companies having an average PLI of 25.78 per cent. Accordingly, the TPO proposed an addition of 19.69 crores which was upheld by the DRP upheld the proposed adjustment made by the TPO subject to the claim of working capital adjustment as per the OECD Guidelines. The TPO was also directed to compute the margins of the comparable companies in accordance with the provisions of the Safe Harbour Rules, introduced in September, 2013. Pursuant to the direction, the TPO reworked the addition to 19.04 crores.

(iii) Aggrieved, the assessee filed an appeal before the Hon'ble ITAT wherein the Tribunal held as that:

- Bodhtree Consulting Ltd., selected as comparable by the TPO, was not comparable to the assessee as it was engaged in software development programmes whereas the assessee was engaged in providing software development services.
- Infosys Ltd. could not be compared to the assessee as the assessee was a captive service provider.

- Thirdware Solutions was to be excluded as comparable as the annual report of the said company did not reveal the bifurcation of sales through SEZ and STPI units.
- Sonata Software was to be excluded as comparable since it mainly dealt in product, sale, offshore development services, research and development as a result of which it was not functionally comparable to the assessee and that it also had significant related party transactions exceeding the 25 per cent RPT filter applied by the TPO.
- TPO must take into account acquisition of TES PV Electronic Solutions Pvt. Ltd. by Mindtree, while determining the comparability of Mindtree.
- The issue of inclusion / exclusion of foreign exchange fluctuation as operating income/ expenses had been dealt with in the decision of the co-ordinate *bench in Westfalia Separator India Pvt. Ltd. vs. ACIT (ITA No. 4446 / D / 02)* and in light of the same the foreign exchange fluctuation was to be considered as operating in nature.

(iv) Aggrieved, the Revenue filed an appeal before the Hon'ble High Court.

Judgment

(i) The Court upheld the order of the Tribunal noting that the Tribunal had undertaken a detailed factual analysis and given cogent reasons for the exclusion of the comparables in question and accordingly held that no substantial question of law arose.

(ii) The Court further held the Safe Harbour Rules, resorted to by the Revenue did not have application to the Assessment Year in question viz. AY 2009-10 since they were notified with prospective effect from September 18, 2013.

2. Companies could not be excluded as comparable merely on the ground of different financial year ending where the companies were functionally similar to the tested party and the financial results for the entire financial year could be reasonably extrapolated. Further, the application of a lower turnover filter without the application of an upper turnover filter was not warranted.

CIT vs. Mckinsey Knowledge Centre India Pvt. Ltd. – TS-672-HC-2015 (Del) – TP

Facts

(i) The assessee, a wholly owned subsidiary of McKinsey Holdings Inc, was incorporated in India to provide various support services in the area of export computer software and IT- enabled services, including data processing, customization of data, back office operations and for the provision of research analysis. The assessee adopted TNMM as the most appropriate method and arrived at 11 comparable companies.

(ii) The TPO only accepted 7 out of the 11 companies selected by the assessee. The TPO rejected Fortune Infotech on the ground that it had a different financial year ending. It further rejected two companies viz. Kirloskar Computer Services Ltd and Mercury Outsourcing Management Ltd on the ground that their turnover was less than Rs. 1 crore. The TPO also rejected Genesis International Corporation Ltd as a comparable on the ground that it had a negative growth graph.

(iii) The CIT(A) and Tribunal ruled in favour of the assesee and allowed the inclusion of the 4 companies as comparable.

(iv) Aggrieved, the Revenue filed an appeal before the Hon'ble High Court.

Judgment

(i) As regards the inclusion of Fortune Infotech Ltd, the Court upheld the order of the Tribunal. It held that where the comparable company was functionally similar to the tested party (the assessee), the same could not be rejected merely on the ground that the data for the entire financial year was not available when the results for the financial year could be reasonably extrapolated.

(ii) It held that Kirloskar Computer Services Ltd. and Mercury Outsourcing Management Ltd could not be excluded on the basis of the lower turnover filter. It further held that if the lower turnover filter was applied, an upper turnover filter was also to be applied which was not done in the present case. Accordingly, it upheld the inclusion of the companies as comparable.

(iii) Further, it held that the TPO was incorrect in excluding Genesis International Corporation Ltd. as comparable on the ground of the company being in a negative growth phase since the annual report of the said company exhibited a considerable rise in income over the past year.

3. Assessee is to be afforded the opportunity to cross examine the authorised personnel of the companies whose segmental data was used by the TPO to benchmark the assessees' international transaction.

Cashedge India Pvt. Ltd. vs. DCIT – TS-445-HC-2016 (Del) – TP

Facts

(i) In the instant case, the TPO, while conducting the benchmarking exercise in relation to the international transactions undertaken by the Petitioner, used segmental data of several companies without affording the Petitioner the opportunity to cross examine the authorised personnel of the said companies even after the Petitioner sought the opportunity to do so.

(ii) The Revenue submitted that all documents were made available to the Petitioner and therefore sufficient opportunity had been granted.

(iii) Aggrieved, the Petitioner filed a writ petition before the Hon'ble High Court.

Judgment

(i) The Court held that where reliance was placed on the data provided by different parties, the petitioner would have no opportunity of rebutting the data unless the persons who submitted the data, were subjected to cross-examination and therefore it remitted the issue back to the TPO for affording the assessee opportunity to cross examine the authorised personnel of the companies.

4. Where the holding companies of the assessee and the company to which the assessee sold its imaging business, entered into a global agreement for the sale of business, since the global agreement did not control the terms and conditions of the actual transaction between the assessee and the buyer, the same could not be considered as a deemed international transaction under section 92B(2) of the Act.

CIT vs. M/s Kodak India Pvt. Ltd. – TS-471-HC-2016 (Bom.) – TP

Facts

(i) The assessee, an Indian subsidiary of M/s Eastman Kodak Co., USA, had, during the relevant assessment year, sold its imaging business to an Indian company viz. Carestream Health India Pvt. Ltd., who was in turn a subsidiary of Carestream Inc, USA.

(ii) The TPO treated the same as a deemed international transaction under section 92B(2) of the Act on the basis that the holding company of both the assessee as well as Carestream India

had entered into a global agreement for sale of its business which was prior to the sale of the imaging business. Aggrieved, the assessee filed objections before the DRP, wherein the DRP upheld the view of the TPO.

(iii) The Tribunal concluded that on the interpretation of Section 92B(2), as in force during the relevant year (i.e. prior to the amendment in Section 92B(2) with effect from April 1, 2015), the transaction would not be covered by the definition of 'international transaction'. Further, the Tribunal held that even if one was to proceed on the basis that Section 92B(2) of the Act was applicable, the transaction would still not come within the definition of international transaction since the transfer was independently between the assessee and Carestream India done on its own terms and conditions and the global agreement between the holding companies did not control the terms of the sale. The Tribunal also noted that the law relevant to the assessment year in question did not permit the use of 'any other method' as the most appropriate method for determination of ALP and therefore it held that the method used by the TPO was incorrect.

(iv) Aggrieved, the Revenue filed an appeal before the Hon'ble High Court for the interpretation of the provisions of Section 92B(2).

Judgment

(i) The Hon'ble High Court upheld the order of the Tribunal and further held that the question of law raised by the Revenue was academic considering the finding of facts given by the Tribunal i.e. that as per Section 92B(2) prevalent during the relevant assessment year, the transaction would not fall within the definition of deemed international transaction and that the transaction of sale was neither controlled by the holding companies of the assessee nor by Carestream India and therefore would not fall under the definition of international transaction. Accordingly it dismissed the appeal of the Revenue.

5. Where the assessee merely changed the basis of computation of royalty payment to its AE (which was initially paid on the basis of Indian Published Price (IPP) / list price and subsequently on the basis of actual sales) which led to an increase in the rate in terms of the percentage, restriction of royalty payment to the prior year's rate was unwarranted since the rate of royalty in prior years was computed on a different basis, especially since when computed on the same basis the rate in earlier years was in fact more than the rate in the relevant year.

CIT vs. Oracle India Pvt. Ltd. – TS-472-HC-2016 (Del.) – TP

Facts

(i) The assessee, Oracle India Pvt. Ltd., a wholly owned subsidiary of Oracle Corporation US, was engaged in the business of distributing Oracle licensed products and providing contract software development to its AEs. During the relevant AY, the assessee paid royalty for duplication and distribution of licensed software to its AE at the rate of 56 per cent of actual sales. The TPO restricted the payment to 30 per cent of sales on the ground that the rate of royalty paid by the assessee in prior years was at 30 per cent and therefore the enhancement in rate was unwarranted. The assessee however pointed out that there was a distinction between the method of computation of royalty rate paid in the earlier years as compared to the current royalty rate and that the effective rate in the prior years was actually 59 per cent. The basis of rate of royalty paid in the prior years was computed at 30 per cent of the Indian Published Price of products licensed to Indian customers which was changed in the relevant year to a percentage of sales, in compliance with the Exchange Control

regulations and to follow the procedure and approval of the FIPB.

(ii) The Tribunal appreciated the submission of the assessee and held that the assessee had moved from the regime of royalty payment as a percentage of list price (IPP Price) to the actual licence price and that effectively the rate of royalty in the relevant year was less than the royalty rate paid in the prior years, if computed on the same basis i.e. on the basis of sales and not IPP.

(iii) Aggrieved, the Revenue filed an appeal before the Hon'ble High Court.

Judgment

The Court upheld the conclusion arrived at by the Tribunal and dismissed the appeal of the Revenue since it did not give rise to any substantial question of law. Further it also noted that the TPO and DRP had accepted the royalty payment at 56 per cent of actual sales in subsequent years.

6. Situs of an intangible capital asset is the situs of its owner. In the absence of enabling legislature, one cannot presume that the intangible capital asset was property situated in India

CUB Pty. Ltd. vs. UOI – TS-401-HC-2016 (Del.)

Facts

(i) The petitioner, an Australian company, had a 100 per cent subsidiary in India viz. Dismin India Pvt. Ltd. (Dismin) which in turn held 100 per cent shares of FBG Mauritius which in turn held 100 percent of shares in Fosters India Ltd. ('Fosters'). The Petitioner and Fosters had executed a brand licence agreement ('BLA') by way of which Fosters was licensed to use in India, four trademarks owned by the Petitioner. In consideration for the same, the Petitioner received royalty which was subject to TDS in India. As per the BLA, Fosters was only permitted to use the licences and the property remained with the Petitioner. Subsequently, a composite agreement was executed by the Petitioner, Dismin, SAB Miller and Fosters Group Ltd. which included the transfer of 16 trademarks (including the 4 provided to Fosters) by the Petitioner to SAB Miller as well as the transfer of shares of FBG Mauritius by Dismin to SAB Miller. As per the said agreement, prior to the transfer of trademarks and shares, the BLA entered into between the Petitioner and Fosters was to be terminated. Accordingly, the Petitioner complied with the said requirement and then assigned the 16 trademarks to SAB Miller.

(ii) The Petitioner filed an application before the AAR to determine whether the receipt arising to its from the transfer of licences was taxable in India. The AAR held that the intellectual property rights / licences were capital assets situated in India and therefore the income on transfer was taxable in India since it accrued in India.

(iii) Aggrieved with the Ruling of the AAR, the Petitioner filed a Writ Petition before the Hon'ble High Court.

Judgment

(i) The Court concurred with the view of the counsel for the Petitioner and held that the situs of an intangible asset was the situs of the owner of such asset. It held that an intangible asset does not have any physical form at any particular location and therefore could not presumed to be situated in India when its owner was outside India. It held that the legislature could have, through a deeming fiction, provided for the location of an intangible capital asset but it had not done so insofar India in concerned. It held that the legislature specifically provided for the situs of shares in an indirect transfer and since there was no like provision for intangible assets, the well accepted principle of *'mobilia sequuntur personam'*, which provides that the situs of the owner of an intangible asset would be the closest approximation of the situs of an intangible asset, was to be followed. Accordingly, since the owner

of the intangible asset was not in India at the time of the transaction, it held that no income accrued to the Petitioner in India from the transfer of its licence to SAB Miller.

7. Extension of stay on 148 notice granted where the notice was in violation of the provisions of section 92CA(2C) in spite of the fact that the assessee did not contest the notice on the said ground before lower authorities

Amore Jewels Pvt. Ltd. vs. Pr CIT – TS-470-HC-2016 (Bom.) – TP

Facts

(i) The Petitioner's assessment under section 143(3) of the Act relevant to AY 2008-09 was completed on October 18, 2010. Subsequently, the AO issued a notice under the section 148 of the Act dated March 31, 2015 to reopen the assessment on the ground that he had reason to believe that the transfer pricing adjustment had escaped assessment under section 147 of the Act.

(ii) Aggrieved with the fact that the notice violated the provisions 92CA(2C) of the Act, which provided that the AO was not empowered to assess / reassess under section 147 or pass an order enhancing the liability of the assessee under section 154 of the Act, for proceedings which have been completed before July 1, 2012, the Petitioner filed a writ petition before the Hon'ble High Court.

Judgment

(i) The Court noted that though the assessee had not challenged the reopening on the aforesaid ground before the lower authorities, since the objection went to the root of the matter, it directed the AO to consider the petitioner's objections in respect to Section 92CA(2C) of the Act and dispose of the same within a period of 4 weeks from the date of filing. Additionally, the Court stayed the impugned notice for a further period of ten weeks from the date of the order (a) so as to enable the petitioner to challenge the order disposing of the objections in respect of Section 92CA of the Act (b) taking into account the decision of the Jurisdictional Court in the case of Asian Paints 296 ITR 90 (Bom.) which directs the AO not to commence reassessment proceedings for a period of 4 weeks from the disposal of objections.

B. TRIBUNAL DECISIONS

8. India-Netherlands DTAA – Taxability of supply of off-the-shelf software – Whether taxable as royalty – Held: No; in favour of the assessee

ADIT vs. Baan Global B. V. [TS-351-ITAT-2016 (Mum.)] – Assessment Year: 2006-07

Facts

(i) The assessee, a non-resident company registered in Netherlands, engaged in the business of development and sale of computer software and provision of other services in relation to its software product, supplied 'off-the-shelf' software in CDs along with licence keys to Indian customers under a 'Distribution Agreement' with its Indian subsidiary (Indian company).

(ii) Payment for the software was made by customers to Indian company which, after retaining its margin, remitted the balance to the assessee. It also received fees for "other general services" (OGS).

(iii) In the absence of a permanent establishment (PE) in India in terms of Indo-Dutch DTAA (the treaty), income from sale of software products was not offered to tax in India, whereas fees for OGS was submitted to tax as 'fees for technical services' (this aspect was not disputed).

(iv) The Tax Officer alleged that the payment for sale of software was in the nature of 'royalty', both under the Act and the Treaty, and hence taxable @ 15%.

(v) Disposing of the TO's appeal, the Commissioner of Income Tax (Appeals) (CIT(A)) held the impugned payment received by the assessee to be from sale of copyrighted product and not from any right in the copyright.

(vi) On a careful examination of the facts (not referred to by the TO), the definition of 'copyright' under section 14 of the Copyright Act, and the ratio laid down in various judicial precedents quoted by the assessee, the CIT(A) concurred with assessee's argument that Indian customers received limited right to access the copyrighted software, without any right to exploit the copyright in the software, and therefore payments under consideration were not in the nature of 'royalty'.

Decision

After extensive discussion of all case law and arguments canvassed by both parties, the Tribunal held in assessee's as under:

(i) Sale of off-the-shelf software entailed transfer of a copyrighted article without any transfer of right to use copyright in the software.

(ii) Such sale could not be covered under 'use of process' in the absence of any access to the source code granted to end-user. Even the source code (computer programmes written in higher level programming languages and readable by humans), did not entail use of a process, as these were for modifying component systems for own internal computing operations.

(iii) Upholding the CIT(A)'s order and relying on various favourable judgments quoted by the assessee, the Tribunal held that a non-exclusive, non-transferable licence (without any right to sublease or sub-licence), with no covenant granting any copyright or right to use, could not be reckoned as royalty within the scope of Article 12(4) of the Treaty. Further, in the absence of a PE in India, such payment could not be taxed as business income under Article 7 of the treaty.

(iv) Further, the Tribunal emphasised that the retrospective amendment brought into the Act could not be read into the Treaty, unless there was a corresponding amendment in the Treaty. Also, in view of the specific definition of the term, 'royalty' under the treaty, there was no requirement to refer the definition of such term under the Act by virtue of Article 3(2).

9. India-Sri Lanka DTAA – Taxability of Capital Gains on sale of an Immovable Property in Sri Lanka –Assessee a dual resident of India and Sri Lanka – Application of Tie Breaker Test under the DTAA – Meaning of the expression "May be Taxed" – Held: Capital Gains taxable in India

Mrs. Shalini Seekond vs. ITO 2016-TII-161-ITAT-MUM-INTL – Assessment Year: 2007-08

Facts

(i) The assessee, a Sri Lankan national, was married to an Indian national and was living in India after her marriage. During the year under consideration, the assessee qualified as a resident of India under the ITL. She also qualified as a resident of Sri Lanka based on her fiscal domicile there, as per the domestic laws of Sri Lanka.

(ii) The assessee owned an immovable property in Sri Lanka, which was sold during the year. The sale proceeds of the property were invested in mutual funds in India and in another property in India

(iii) The issue before the Tribunal was whether the gains derived from sale of such immovable property are taxable in India under the provisions of the ITL, as well as the DTAA.

(iv) The A.O. held that the assessee was a resident in India and any income arising in India or outside India is fully taxable in India. Hence, the capital gains arising from the sale of the Sri Lankan property should be offered to tax in

India, subject to any double taxation relief from taxes paid in Sri Lanka as per the provisions of the DTAA. As no tax was paid in Sri Lanka, no relief could be granted to the assessee in India and capital gains arising thereof were fully taxable in India. Reliance was placed on Notification No. 91 of 2008 dated 28th August ,2008 (Notification) issued by the Government of India (GoI), which clarified that where any DTAA uses the expression "may be taxed in the other country", such income shall be included in his/her total income chargeable to tax in India and relief shall be granted in accordance with the method for elimination or avoidance of double taxation provided in such DTAA.

(v) The assessee contended that:

a) The assessee's treaty residency was situated in Sri Lanka based on the tie-breaker rule of the DTAA. She had a permanent home in Sri Lanka because her parents were residing there and she owned one immovable property in Sri Lanka (which was sold in the relevant tax year). Furthermore, she did not own any property in India.

b) As per the DTAA, Gains derived from the sale of an immovable property situated in Sri Lanka are taxable only in Sri Lanka. The assessee relied on certain Supreme Court decisions [2] to contend that the term "may be taxed" used in the capital gains provision of the DTAA should be interpreted as "shall only be taxed". Principles under the Notification cannot be applied as the Notification was not effective as on the date when the DTAA was entered into.

c) Sri Lanka has the right to tax such capital gains. Even if the capital gains tax under the domestic laws of Sri Lanka is nil or zero, the same does not grant India a right to tax such gains and relief under the DTAA is still available.

Decision

The Tribunal held in favour of the Revenue as under:

A) Re: Residential status of the Assessee

i) It is undisputed that the assessee was a resident in India as per the ITL, which was further confirmed by the assessee who declared her status as being "resident in India" in the return of income.

ii) Under the tie-breaker rule of the DTAA, the Assessee qualifies as a resident of India on the following basis:

a) The Assessee has a permanent home available to her in India, being the home of her husband after marriage. The availability of a permanent home has nothing to do with ownership of a home in the country of residence, but refers to a place of abode or dwelling in the country of residence and an abode available to her at all times continuously and not occasionally for a short duration.

b) The word "habitual abode" requires actual living habitually, consistently and regularly in a country. Mere ownership of one immovable property or living of parents of a married woman in Sri Lanka does not make her habitual abode in Sri Lanka, unless it is demonstrated with cogent evidences that the assessee was living in both India and Sri Lanka permanently, regularly and consistently, thereby satisfying the test of "habitual abode".

c) The assessee's economic and personal relations have close proximity to India post marriage with an Indian national. She has retained her centre of vital interest in India after her marriage by moving to India to stay with the Indian national permanently.

d) The assessee holds a lifelong, valid multiple visa issued by the GoI to enable

her to stay in India indefinitely with her husband. This also reflects her intention to stay or settle permanently in India.

e) Proceeds from the sale of the Sri Lankan property were utilised for buying assets in India, which clearly reflects the strategic shift of vital economic interest to India from Sri Lanka.

(iii) Accordingly, the assessee qualified as a resident of India under the ITL, as well as the DTAA.

B) Re: On the meaning of the expression "may be taxed" and retrospective applicability of the *Notification*

(i) The provisions of the ITL clearly stipulate that the GoI has the powers to assign the meaning to any term used, but not defined, in the ITL or a DTAA provided the same shall not be inconsistent with the provisions of the ITL or the DTAA, or unless the context otherwise requires. It is in exercise of this power that the GoI issued the Notification assigning meaning to the expression "may be taxed".

(ii) The meaning assigned in the Notification is in respect of a term used in a tax treaty entered into by the GoI with an intent and objective as understood during the course of negotiations leading to formalisation of the tax treaty. The Notification, thus, gives a legal framework for clarifying the intent. Such Notification has to be read from the date when the India–Sri Lanka DTAA came into force.

(iii) Furthermore, it can be observed from the plain language used in the Notification that it is merely procedural in nature and no additional liability is sought to be fastened on the assessee by issuance of the said Notification. Thus, retrospective application of the Notification cannot be questioned.

C) On taxability of capital gains under the DTAA

(i) As per the DTAA, the capital gains arisen to the assessee from the sale of the immovable property situated in Sri Lanka are taxable in Sri Lanka i.e., Sri Lanka gets a right to tax such income. The fact that the tax liability on such gains is nil or zero does not impact the rights of taxation allocated in terms of the DTAA.

(ii) By virtue of the Notification, such capital gain income shall be included in the income of the assessee, chargeable to tax in India under the provisions of ITL and the relief shall be granted as per the provisions of the DTAA to avoid double taxation and prevention of fiscal evasion of the taxes. In this case, double taxation relief is "nil"' as no taxes are paid in Sri Lanka.

10. Transfer Pricing – Definition of "Associated Enterprises" – Two enterprises cannot be treated as an associated enterprise unless both the parameters laid down in Section 92A of the Income-tax Act are fulfilled – In favour of the assessee

M/s. Page Industries Ltd. vs. DCIT 2016-TII-355-ITAT-BANG-TP – Assessment Year: 2010-11

Facts

(i) The assessee is engaged in the business of manufacture and sale of readymade garments. The company is a licensee of the brand-name 'Jockey' for the exclusive manufacturing and marketing of Jockey's readymade garments under the licence agreement with Jockey International Inc, U.S. (JII), a company incorporated in U.S. and the owner of the brand Jockey. The assessee owned the entire manufacturing facility, capital investment, employees and there was no participation of JII in the capital and management of the assessee.

(ii) In consideration for granting the right to use the brand-name, the assessee paid consideration in the form of royalty at the rate of 5 per cent of the sales to JII. The Form 3CEB was filed by the assessee disclosing the payment of royalty transaction.

(iii) During the AY 2010-11 the assessee incurred expenditure on Advertisement, Marketing and Product Promotion (AMP) to increase its sales. The TPO stated that the AMP expenditure incurred by the assessee was done on behalf of JII to promote their brand name and hence, such costs should have been recovered by the assessee from JII. The TPO categorised the said expenses as an international transaction in the nature of the brand building and determined the Arm's Length Price (ALP) by applying Bright Line Method.

(iv) The TPO proposed adjustment in relation to both royalty and AMP expenses.

(v) The assessee contended that:

a) The transaction pertaining to payment of royalty was reported in the accountant's report only out of abundant caution, and actually there does not exist an AE relationship with JII, which would invoke the provisions of Chapter X of the Act.

b) Without prejudice to the above, the assessee also contended that the TPO erred in concluding that AMP expenses are an international transaction and computing ALP for the same, without appreciating that the AMP expenses were incurred by the assessee for its own business purposes and not for the brand building of JII.

c) The TPO erred in aggregating royalty and advertisement expenditure for determining ALP without appreciating the fact that both the transactions are distinct and have different FAR and without considering the fact that the royalty payments have nothing to do with the incurring of AMP expenses.

d) The TPO unilaterally adopted comparables selected by the assessee under Transactional Net Margin Method as comparable under Comparable Uncontrolled Price (CUP) method without demonstrating how they remain comparable under the CUP method also.

Decision

The Tribunal held in favour of the assessee as follows:

(i) The Tribunal rejected TPO's view that the two enterprises (i.e. the assessee and JII) should be treated as associated entities under Section 92A considering the amendment made to Sec 92A(2) *vide* Finance Act, 2002 effect from 1st April, 2002, which provides that 'in order to constitute a relationship of an AE, the parameters laid down in both sub-sections (1) and (2) of Section 92 should be fulfilled'.

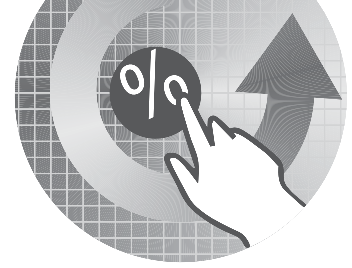
(ii) Tribunal observed that while interpreting a provision in a taxing statute, the construction should preserve the purpose of the provision. If more than one construction is possible, that which preserves its workability and efficacy is to be preferred to the one which would render it otiose or sterile.

(iii) In the above context, Tribunal held that even if the assessee and JII may be related as per Section 92A(2)(g) but till the time their relationship will not satisfy the conditions laid down in 92A(1) they cannot be construed as AEs, and therefore the provisions of Chapter X of the Act have no application.

(iv) Accordingly, the Tribunal held that the transfer pricing adjustment made by the TPO is not valid in law.

Comment

This Tribunal ruling highlights that Sections 92A(1) and 92A(2) cannot be read independently while determining the relationship between the enterprises. This view pronounced by the Tribunal could be the subject matter of intense debate.



CA. Hasmukh Kamdar

INDIRECT TAXES
Central Excise and Customs – Case Law Update

S. L. Lumax Ltd. vs. Commissioner of Central Excise, Chennai – IV – [2016 (337) E.L.T. 368 (Mad.)]

CENVAT Credit

Facts in this case are as follows

The appellant had its registered office at New Delhi and was located in Irunkatukottai, Sriperumbudur Taluka, Kancheepuram District.

Appellant imported injection moulding machines in1998 and after filing the necessary declarations under Rule 57T of the Central Excise rules, availed MODVAT Credit on 30-6-1999, in respect of CVD paid on import of these machines.

In the Income Tax Returns for the financial years 1998-99, 1999-2000 and 2000-01, the appellant claimed depreciation for the whole of the machinery, including the duty component, on which MODVAT Credit was already availed. This was detected by the office of the Headquarters Preventive Unit on 5-3-2002.

Immediately, the appellant filed an application under Section 154 of the Income-tax Act, 1961 for the rectification of mistake. By this time, the returns filed by the appellant for the financial years 1998-99 and 1999-2000 had already been accepted.

However, the appellant filed revised returns for the Financial Years 1999-2000 and 2000-01 along with Revised Computation of Loss. The application for rectification was also made under Section 154 of the Act,

By an order dated 9-1-2004, the petition for Rectification under Section 154 of the Act in respect of the Assessment Year 1999-2000 was rejected on the ground that only revised returns ought to have been filed.

On appeal by the appellant, the Commissioner (Appeals) allowed the application for rectification of mistake, by his order dated 31-5-2004 and set aside the order of refusal dated 9-1-2004 passed by the Assessing Officer.

This order of the Commissioner (Appeals) was set aside by the Tribunal which order was confirmed by the High Court and the Supreme Court. As a consequence, the Original Order of the Assessing Officer dated 9-11-2004, refusing to permit the rectification of return under Section 154 of the Act became final.

In other words, the benefit that the appellant can be said to have unlawfully claimed, by way of depreciation even on the component of duty on which MODVAT Credit had been taken, was withdrawn by the assessee in respect of Assessment Years other than F.Y. 1998-99.

In the meantime, a show cause notice dated 28-5-2004 was issued by the Additional Commissioner of Central Excise, calling upon the appellant to show cause as to why the MODVAT Credit taken by them should not be withdrawn. This show cause notice resulted in an Order-in-Original dated 28-9-2004, directing the recovery of the MODVAT Credit together with interest and penalty for an equivalent amount. However, the Additional Commissioner observed in his Order-in-Original that the appellant would be eligible for MODVAT Credit after 30-5-2004, the date of acceptance of withdrawal of depreciation by the Department. This Order-in-Original of the Additional Commissioner has been accepted by the Department. However, as against the recovery of the MODVAT Credit, the appellants filed an appeal. The appeal was allowed by the Commissioner (Appeals), by an order dated 21-1-2005.

Department filed an appeal before the Customs, Excise and Service Tax Appellant Tribunal against the said order of Commissioner (Appeals) dated 21-1-2005. The appellants filed cross-objection on the ground that on account of withdrawal of depreciation on 30-5-2004 MODVAT credit is available after that date.

By an order dated 25-3-2005, the Tribunal allowed the appeal filed by the Department and restored the Order-in-Original. Unfortunately, even while restoring the Order-in-Original, the Tribunal did not take note of that portion of the Order-in-Original which entitles the appellant to take MODVAT Credit from 30-4-2005.

Therefore, the assessee approached this Court with following substantial questions of law:

"1. Whether the Hon'ble CESTAT was justified in allowing the Department appeal ignoring the admitted fact that the appellant has fully given up the depreciation claimed under the Income-tax Act, 1961, as admitted by the Income tax Department in the collateral proceeding before Supreme Court for the Assessment Year 1999-2000 and in the revised returns for the subsequent year?

2. Whether the Hon'ble CESTAT was justified in concluding wilful misdeclaration when indeed even on the date of investigation in February-March, 2002, the depreciation claimed has remained un-utilised which in any event was given up in the subsequent IT Returns?

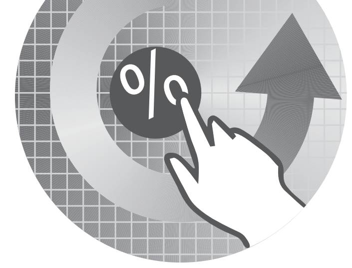
3. Whether the Hon'ble CESTAT was justified in upholding the demand when indeed the appellant has given up the depreciation which remained unabsorbed in the Income Tax Return in revised Income Tax Return?

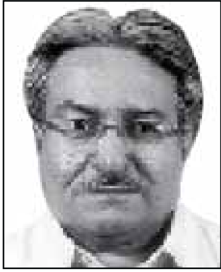
4. Whether the Hon'ble CESTAT was justified in upholding the demand when indeed depreciation is claimed at the rate of 10.34% per annum when the entire depreciation has been given up?"

The Hon'ble High Court observed that from the facts narrated above, it can be seen that the appellant, though entitled to one of the two benefits, availed both the benefits. After detection by the Preventive Unit, the appellant chose to file an application for rectification under Section 154 of the Act as well as revised returns is respect of the Assessment Years 1999-2000 and 2000-01. They were accepted. In so far as the Assessment year 1998-99 is concerned, the time-limit for filing a revised return had already expired and the attempt of the appellant to file application for rectification under Section 154 of the Act failed up to the Supreme Court.

In simple terms the assessee started up with a claim for two benefits and ended up with losing both the benefits. Therefore, the question is as to whether at least after the appellant realised his mistake and had

[Contd. on page 118]





CA Janak Vaghani

INDIRECT TAXES
VAT Update

1) Trade Circular

Trade Circular No. 20T of 2016, dated 19-7-2016.

FAQs on the Settlement of Arrears in Dispute Act, 2016.

The Commissioner of Sales Tax by above referred Trade Circular has issued third set of FAQ on the Settlement of Arrears in Dispute Act, 2016. In the above circular all FAQs issued are clubbed together.

2) Website Updates

i) Facility to upload Form I under the Settlement of Arrears in Dispute Act, 2016.

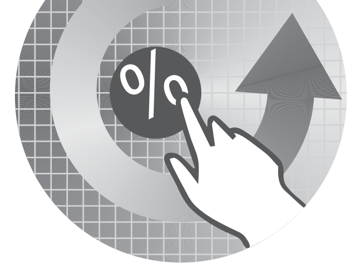
Facility to upload Form I, an application for Settlement of Arrears in Dispute is made available under "e services>e-Amnesty 2016".

ii) Goods and Services Tax – An Overview.

The Department has issued "Goods and Services Tax – An Overview" on Draft Model GST Law which is made available on website under "What's New" section.

ERRATA

In the Chamber's Journal of July 2016 page Nos. 69 and 73 the author of the Special Story Shri Ganesh Rajgopalan's designation is wrongly printed as Advocate. He is a Chartered Accountant. The error is regretted.



CA Rajkamal Shah & CA Naresh Sheth

INDIRECT TAXES
Service Tax – Statute Update

1. Instructions Regarding Provisional Attachment of Property

Following the Hon'ble Allahabad High Court after a detailed analysis of the legal provisions that the order directing attachment of the property without waiting for a reply to the show-cause notice, and without giving any opportunity and without giving any notice, was in gross violation of Rule 3 of the Rules of 2008 read with paragraph 2(iii) of the Circular dated 1st July, 2008. It was mandatory for the authority to issue a notice giving 15 days time to reply before attaching a property.

It has been now clarified that there are adequate safeguards in the law and same have been highlighted in the Circular 103/06/2008-ST dated 1-7-2008. The present situation has resulted only on account of non-compliance with respect to both. Chief Commissioners are requested to issue standing orders with respect to the observations of the Hon'ble Allahabad High Court and to also emphasizes that non-compliance with legal provisions or administrative instructions will leave officers with no defence in legal proceedings arising out of such non-compliance.

[Circular No.196/06/2016-ST, dated 27-7-2016]

2. Permission to Pay Service Tax through Non-Electronic Mode

The Board has taken serious view of non-grant of permission to the Department of Posts to pay service tax by cheque instead of electronically through internet banking, despite the fact that the Rule 6(2) of the Service Tax Rules, 1994 the jurisdictional Deputy/Assistant Commissioner, may, for reasons to be recorded in writing, allow the assessee to deposit service tax by any other mode. Accordingly, it is directed that the discretion vested in the jurisdictional Deputy/Assistant Commissioner under Rule 6(2) of the Service Tax Rules, 1994, should be exercised judiciously and rationally. The supervisory officers should, from time-to-time, check such exercises of discretion so that there are no unwarranted refusals.

[Instruction F. No.137/08/2013-ST, dated 22-7-2016]

CA Bharat Shemlani

INDIRECT TAXES
Service Tax – Case Law Update

1. Services

Construction Service

1.1 Suresh Kumar Bansal vs. UOI 2016 (43) STR 3 (Del.)

The High Court in this case held that, construction of complex intended for sale by builder before, during or after construction deemed to be service provided by builder to buyer is *ultra vires* as there was no statutory mechanism to ascertain value of service component subject of levy. Service tax cannot be levied on value of undivided share of land acquired by buyer of dwelling unit or on value of goods which are incorporated in project by developer. Levying tax on constitute of goods or land would be intruded into legislative field reserved for State under Constitution of India.

Rule 2A of Valuation Rules, 2006 does not determine value of services in case of composite contract involving sale of land. Neither Valuation Rules, 2006 nor FA, 1994 have any provisions for determining value of service covered under construction service. The abatement to the extent of 75% by Notification or Circular could not substitute lack of statutory machinery. However, preferential location charges do not relate solely to location of land and cannot be traced directly to value of any goods or value of land but are as a result of development of complex as whole and position of particular unit in context of complex and therefore liable to service tax.

Programme Producers Service

1.2 CST-VI, Mumbai vs. Balaji Telefilms Ltd. 2016 (43) STR 98 (Tri.-Mumbai)

The assessee in this case produced programmes in Hindi with intent to be distributed to viewers in India through channels in India, for uplinking by Hong Kong based entity and received payment in Indian rupees. The assessee claimed the same services as export of service. The Tribunal held that, condition for export stipulated in rule 3(2) of ESR, 2005 were complied with. Usage of programme after delivery to overseas entity was irrelevant in decision upon tax liability as "programme producer". The services rendered by assessee was delivered/provided from India to overseas entity and used outside India. It is further held that, it was immaterial that Indian rupees was currency for payment as assessee had produced certificate from Hong Kong Bank that inward remittance from overseas entity was in convertible foreign currency and the contention of assessee that, designated Indian currency was for prevention of loss on account of currency fluctuation was upheld.

Business Auxiliary Service

1.3 C. M. Sakpal vs. CCE, Nagpur 2016 (43) STR 106 (Tri.-Mumbai)

The appellant in this case engaged in providing services of displaying and storage of goods of a SPA and entitled for remuneration based on

quantum of sale. The Tribunal held that, payment to assessee of a minimum guarantee per month could not detract from connection with sale and the arrangement was of commission agency which became taxable for non-agricultural produce in hand of provider of service. The expression 'commercial concern' includes HUF and members thereof.

1.4 Sharyu Motors vs. CST, Mumbai 2016 (43) STR 158 (Tri.-Mumbai)

The Tribunal in this case held that, commission received for marketing auto loan products is liable to service tax. It is further held that, amount received for achieving target under Target Incentive Scheme is not liable to tax under BAS and it is only trade discount extended to assessee for achieving sales target.

1.5 Chhabria Marketing Ltd. s. CST, Mumbai 2016 (43) STR 193 (Tri.-Mumbai)

The appellant in this case was engaged in marketing and selling of IMFL and received commission per case of IMFL/Beer actually sold, however also carried out other activities such as arranging production of goods by engaging bottlers/distillers up to collection of sale proceeds etc. The Tribunal held that, benefit of Notification No. 13/2003-ST could not be denied on the ground that, it was available only in respect of sale or purchase of goods. It extends to all BAS provided by commission agent and not merely to services of selling or purchasing goods on behalf of client. It was immaterial that commission agent was defined under Notification as person providing service in relation to purchase or sale of goods, as it was only for defining eligibility criterion. If person was found to be commission agent because of sale or purchase for consideration linked to quantum thereof, benefit exemption would cover all BAS rendered by agent.

1.6 Greenwich Meridian Logistics (I) Pvt. Ltd. vs. CST, Mumbai 2016 (43) STR 215 (Tri.-Mumbai)

The assessee in this case provided handling logistic for delivery to consignee, taking responsibility for safety of goods, issuing document of title, and committing delivery to consignee. Further to ensure such safe delivery, assessee contracting with carrier by land, sea or air, without diluting its contractual responsibility to consignor. The Tribunal observed that, shipper was not privy to minutiae of such contract for carriage and often such contracts entered into even in absence of shippers in anticipation of demand as distinct business activity with risk of its non-usage. It is held that, allotment of procured space to shippers at negotiated rates within total consideration in multi-modal transportation contract with consignor was distinct principal to principal transaction. Assumption of risk was not within the scope of agency function. Notional surplus earned from purchase and sale of space and not by acting for client. With space so purchased being allocable only to assessee, shipping line fails in description as client whose services are promoted or marketed. Hence such surplus was not liable to service tax under BAS.

1.7 Bhaven Desai vs. CST, Mumbai 2016 (43) STR 235 (Tri.-Mumbai)

The Tribunal in this case observed the distinction between BAS and BSS. It is held that, from the view point of recipient of service, BAS is outsourcing in relation to externality of business entity while BSS is outsourcing of internal activities of business entity. The perusal of respective description of two services in FA, 1994, makes it abundantly clear that legislation had deliberately acknowledged the dichotomy in practice of outsourcing by business entities.

It is further held that, section 67 of FA, 1994 though mandates tax payment on 'gross amount charged by service provider', a tax cannot be determined on total receipts owing to qualification of 'for such service rendered by appellant' therein. The chargeability of certain amounts received being attributable to a peculiar taxable service cannot be presumed to confer authority to tax other amounts received from same entity for service unknown. The bulk of expenses incurred on salaries, telephones, office space and advertisement, all of

which may not be considered to be essential to bring banking institution to doorstep of customer and is thereby inextricably enmeshed with financial product offered by bank. The costs claim to be reimbursable, therefore not attributable to BAS rendered by appellant but to cost of product itself. Such cost falls outside the scope of inclusion within the meaning of 'gross amount charged' in section 67.

1.8 Jak Traders Pvt. Ltd. vs. CCE, Kanpur 2016 (43) STR 259 (Tri.-All.)

The appellant in this case engaged in facilitating their clients in expeditious and/or timely receipt of various export incentives by filing drawback claims, application for DEPB, EPCG licences, processing application for Star Export House Certificate etc. The Tribunal observed that, appellants neither facilitated sale of any goods of their client nor service and they were not involved in any activity directly relating to promoting or marketing of goods. The appellant's role comes after the goods were sold and exported, hence not liable to service tax.

1.9 Goyal Automobiles vs. CCE, Chandigarh-II 2016 (43) STR 268 (Tri.-Del.)

The Tribunal in this case held that, commission on distribution of SIM cards is not liable to service tax in Distributors hand as BAS and it is settled law that, in case of Telephone service the principal providing said service is liable to tax on MRP and commission is included in MRP.

Technical Consultancy Service

1.10 Magarpatta Township Dev. & Const. Co. Ltd. vs. CCE, Pune-III 2016 (43) STR 132 (Tri.-Mumbai)

The appellant in this case availed services from foreign architect for designing and planning of various commercial buildings and not paid service tax in respect of Income Tax borne by them. The Tribunal held that, there is nothing in record to indicate that, assessee had recovered TDS and they were liable to pay service tax only on invoice amount.

Management, Maintenance & Repair Service

1.11 Tanya Automobiles (P) Ltd. vs. CCE&ST, Meerut-I 2016 (43) STR 155 (Tri.-All.)

The Tribunal in this case held that, cost of items supplied/sold such as spare parts and lubricants in course of providing services of maintenance or repair of motor vehicles is not included in taxable value, when shown separately.

Management Consultancy Service

1.12 PIEM Hotels Ltd. vs. CCE, Nashik 2016 (43) STR 211 (Tri.-Mumbai)

The appellant hospitality service company provided advice, consultancy and assistance directly connected with management of hotel and provided key senior personnel for assistance to conduct hotel business with infrastructure and manpower of the hotel. The Tribunal observed that, neither hotel business was conducted/promoted nor any service provided on behalf of hotel to its customers and held that, service provided to hotel were Management or Business Consultant's Service and not BAS.

Banking & Other Financial Service

1.13 Gitanjali Gems Ltd. vs. CST, Mumbai-I 2016 (43) STR 230 (Tri-Mumbai)

The Tribunal after relying on majority decision in case of *Tata Steel Ltd. 2016 (41) STR 689 (Tri.)* held that, charges paid to overseas agent in case of ECB are liable to service tax under RCM.

Seismic Job and Topographical Survey Service

1.14 Visesh Engineering Co. vs. CCE&ST, Guntur 2016 (43) STR 232 (Tri.-Hyd.)

The Tribunal in this case held that, in view of Tribunal's decision in *Urvi Constructions 2010 (17) STR 302 (Tri.)* service tax is not demandable from sub-contractor when main contractor has discharged service tax on same activity for same period. It is further held that, the information received under RTI has evidentiary value and the department could have verified the details which they failed to do so, hence appeal is allowed.

2. Interest/Penalties/Others

2.1 Mega Cabs Pvt. Ltd. vs. UOI 2016 (43) STR 67 (Del.)

The High Court in this case held that it is settled law that, Rules being a subordinate legislation must conform to provisions of main statute and must also come within scope of rule making power. The audit being a specialised function is different from verification of records and cannot be carried out by departmental officers. Further verification of records can take place by officers who are authorised to assess returns or conduct special audit or conduct investigation for purpose of adjudication. The FA, 1994 do not empower every officer to demand production of records. The Rule 5A(2) is being in excess of legislative delegation, ultra vires of FA, 1994 and hence required to be quashed.

2.2 CCE, Vadodara vs. Gujarat Container Ltd. 2016 (43) STR 90 (Guj.)

The High Court in this case held that, SCN without providing details of unpaid service tax on GTA service which is proposed to be recovered is merely of general nature making fishing inquiry and therefore liable to be set aside.

2.3 Sumeet C. Tholle & Others vs. CCE&C, Aurangabad 2016 (43) STR 110 (Tri.-Mumbai)

The appellant in this case claimed refund on the ground that, the collection of tax was without authority of law as construction of single unit in Group Housing Complex was not covered under definition of service and the service tax was borne by him. The Tribunal held that, the said service provided to appellant is not liable to service tax and therefore service tax collected by vendor from appellant and deposited in Government account is liable to refunded. It is further held that, refund cannot be rejected on the ground that proof of deposit of service tax in Government account by service provider is not made available when service recipient is producing receipt/invoice issued by service provider and verification if any can be done by department.

2.4 Persistent Systems Ltd. vs. CCE&ST, Pune-III 2016 (43) STR 117 (Tri.-Mumbai)

In this case, the appellant paid service tax under protest on Management, Maintenance or Repair Service during investigation and filed refund claim thereafter with request to keep claim in abeyance. The adjudicating authority returned said claim by an order holding that, since proceeding for appropriation of impugned amount are in progress refund claim is premature. The Tribunal held that, undoubtedly there is no law for keeping refund claims in abeyance and return the same without taking a decision either way is also not prescribed in law. The matter remanded for fresh decision on refund claim on merits.

2.5 Repro India Ltd. vs. CCE, Belapur 2016 (43) STR 203 (Tri.-Mumbai)

The department in this case returned refund claim filed for insufficiency of supporting evidence. On re-submission after lapse of time, refund is rejected as time barred. The Tribunal held that, refund claims were not time barred. Return of applications for rectifying deficiencies and re-filing indicated that competent authorities were aware that claims had been filed on time. If completeness of application was I for admissibility of application, claim could well have been rejected by immediate issue of SCN and adjudication thereupon instead of taking course that it did.

2.6 L&T Sargent & Lundy Limited vs. CCE&ST, Vadodara 2016 (43) STR 249 (Tri.-Ahmd.)

The appellant in this case adjusted excess service tax paid towards service tax liability of subsequent month, which is denied by the department. The Tribunal held that, there is no dispute that, *suo motu* adjusted amount had been paid in excess and infringement of prescribed procedure is not serious enough to deny substantial benefit. There being no short payment, said adjustment regularised.

2.7 Movik Networks India Pvt. Ltd. vs. CST, Bengaluru 2016 (43) STR 263 (Tri.-Bang.)

The Tribunal in this case held as follows:

- General Insurance, Air Travel Service and Telecom services are covered within definition of input service.
- Non-filing of refund claim monthly/quarterly being a procedural requirement, cannot overrule substantive law. Refund not to be denied on such lapse.
- Refund of certain input services availed prior to registration cannot be denied.

3. CENVAT Credit

3.1 CST Bengaluru vs. Tavant Technologies India P. Ltd. 2016 (43) STR 57 (Kar.)

The High Court in this case held that, since assessee was exempt from payment of service tax and Department was not able to show any liability of assessee which was required to be adjusted against CENVAT credit the grant of refund is sustainable. Further it is held that, there is no rule or statutory provision which makes registration mandatory for availment and utilisation of CENVAT credit.

3.2 Delcam Software India Pvt. Ltd vs. CCE, Pune-I 2016 (43) STR 103 (Tri.-Mumbai)

The Tribunal in this case held that, for period prior 1-4-2011, trading was not treated as exempt service hence credit of service tax on input services used in common for output service and trading to be apportioned as per their turnover, and demand for reversal of CENVAT credit upheld.

3.3 Vodafone Essar Spacetel Ltd. vs. CCEC&ST, BBSR-I 2016 (43) STR 124 (Tri.-Kolkata)

The appellant in this case claimed CENVAT credit of duty paid on capital goods installed in the State of J&K. The Tribunal held that obtaining centralised registration at Bhubaneswar does not mean that branch in J&K starts providing service from Bhubaneswar. Further, J&K branch was not required to be included in centralised registration as no taxable services were provided therefrom. Hence, no CENVAT credit of duty/tax paid on capital goods, inputs and input services availed by J&K branch is available.

3.4 Khanna Industrial Pipes P. Ltd. vs. CCE, Thane-I 2016 (43) STR 209 (Tri.-Mumbai)

The appellant in this case claimed CENVAT credit of service tax paid for services received up to Port of clearance and beyond that also. The Tribunal held that, as per CBEC Circular No. 999/6/2015-CX dated 28-2-2015, Port of clearance is place of removal for manufacturer-exporter and they are entitled to credit of service received up to there. However, for services availed at destination which is beyond place of removal and outside India, credit cannot be claimed.

3.5 Bovis Lend Lease India Pvt. Ltd. vs. CST, Bengaluru 2016 (43) STR 253 (Tri.-Bang.)

The appellant in this case claimed CENVAT credit of service tax though not mentioned separately in Invoice. The Tribunal held that rule 3(1) of CCR, 2004 stipulates that tax amount required to be indicated separately on invoice and credit is deniable on failure to comply with provisions of said rule.

3.6 Pradeep Singh & Associates vs. CCE&ST, Surat 2016 (43) STR 265 (Tri.-Ahmd.)

The Tribunal in this case denied CENVAT credit of service tax paid on lifetime membership paid to MCA club as the same is not having any nexus with Chartered Accountant's Service.

3.7 Sundaram Fastners Ltd. vs. CCE, Chennai-IV 2016 (43) STR 267 (Tri.-Chennai)

The Tribunal in this case allowed CENVAT credit of service tax paid on catering services availed for maintenance of canteen in factory being an obligation under Factories Act. However, not allowed CENVAT credit of service tax paid on renting of cycle stand in factory as not having nexus with output services provided or manufacturing activity carried out.

Janak C. Pandya, Company Secretary

CORPORATE LAWS
Company Law Update

Case Law No. 1

[2016] 197 Comp Cas 42 (Delhi)
[In the Delhi High Court]
Jasmohan Singh and Others
vs.
(1) Freeze Kind Industries P. Ltd and Others
(2) Koldhold Industries P. Ltd. and Others

Shareholders have a right to inspect the statutory records of the Company, but the use of information derived from inspection thereof to any other forum shall be subject to prior approval of the CLB.

Brief Case

Two applications were made by the appellants challenging two orders of the Hon. Company Law Board ("CLB"). Appellants had filed two petitions under sections 397, 398 and 402 of the Companies Act, 1956 ("Act"). The petitions were filed for alleged oppression and mismanagement by the respondents. The petitions sought various reliefs, including interim reliefs. One of the interim reliefs was for inspection of statutory records of the respondent companies in the presence of a chartered accountant.

CLB passed an interim order for carrying out the inspection. However, the respondents had written to the appellants that unless an undertaking was furnished that the information derived during the course of inspection shall be used only for prosecuting the petition which they have filed and not for any other forum. In another petition, the CLB passed an order asking the appellants to give an undertaking that information derived will not be used in another forum without the prior approval of the CLB.

The following submissions were made by the appellants:

1. There is an unfettered right to seek inspection of the records of the companies.

2. CLB has no power to stipulate conditions while allowing the inspection or jurisdiction to stop the appellants from instituting any other proceedings in any forum. Reliance was placed on section 41(b) of the Specific Relief Act, 1963 and the Supreme Court judgment in the case of *Cotton Corporation of India Ltd. vs. United Industrial Bank Ltd. [1983] 4 SCC 6245; [1984] 55 Comp Cas 423 (SC).*

3. The legal rights cannot be impeded on use of information received during the inspection.

4. Issue related to oppression and illegal activity can be found only upon inspection.

5. The conditions were not mentioned earlier and this is first time that the conditions were mentioned.

6. Law mandates to report to police officer as to commencement of any cognisable offence, which in accordance with the provisions of section 154 of the Code of Criminal Procedure, 1973 has to take further action. Reliance was placed on judgment of a single judge in *S. P. Gupta vs. State (NCT of Delhi) [2005] 119 DLT 214; [2006] 132 Comp Cas 402 (Delhi).*

The respondent argued that the right to inspection could not be abused. The appellants have filed several complaints before various statutory authorities including the Economic Offences Wing. The purpose is to impede the business of the concerned companies. It was submitted that the right of inspection is not unfettered. The reference of the judgment of a single judge in the matter of *D. Ross Porter v. Pioneer Seed Co. Ltd [1989] ILR 1 Delhi 150; [1990] 68 Comp Cas 145 (Delhi).* The respondents also relied on the report of the Company Law Committee, 1952. Chapter XII on Inspection and Investigation.

Judgment and reasoning

The Court set aside the orders of the CLB. The Court allowed the appellants to carry out the inspection. It has also indicated that the appellants have to give an affidavit as to manner and forum before which they propose to use. CLB has to then pass a fresh order if it is inclined to injunct the use of such information.

[Contd. on page 109]

foregone one of the benefits the appellant should still be penalised? The answer to this question would be an emphatic no. It is true that only after detection by the Preventive Unit, the appellant attempted to withdrawn one of the two benefits. But the mistake has been explained by the assessee on the ground that their registered office was located in New Delhi and their factory was located in Tamil Nadu. The calculation of depreciation in so far as it relates to the duty components, on which MODVAT Credit has already been claimed, is certainly a tedious process. However, it does not mean that the appellant can have the licence to commit a mistake but once the mistake is detected and he filed revised returns, deprivation of the benefit of MODVAT Credit could only be punitive. This cannot be the object of the grant of MODVAT Credit.

The Original Authority declared the entitlement to MODVAT Credit from 30-4-2005. Now while restoring the Order-in-Original, the CESTAT has modified that portion also, without there being an appeal by the Department to the Appellate Commissioner against the Order-in-Original. Therefore, the appellant is entitled to succeed.

In view of above, the appeal was allowed and the substantial questions of law were answered in favour of the appellant. However, it was made clear that the Original Authority shall workout the total amount of depreciation given up by the appellant, despite losing the battle in relation to the Assessment Year 1998-99, for the purpose of finding out the extent to which the appellant is entitled to the benefit.

ERRATA

In the July 2016 issue of The Chamber's Journal (Page 100), the article "Direct Taxes – High Court" is written by Mr. Ashok Patil, Advocate and Ms. Priti Shukla, Advocate However inadvertently, the name of Ms. Priti Shukla was not printed in this article. The error is regretted.

Ajay Singh, *Advocate &* CA Namrata Bhandarkar

BEST OF THE REST

1. *Res judicata* – Erroneous determination of pure question of law in previous judgment – Will not operate a *res judicata* in subsequent proceeding in relation to other property between same parties – No equitable principle or estoppel can impede powers of Court to determine an issue of law correctly in subsequent suit: Civil Procedure Code Section 11; Evidence Act Section 115

The land in dispute was the property of Kishun, who had five sons out of which three sons died issueless and the properties of Kishun was inherited by the remaining two sons Bechai and Kanhai alone. The dispute arose at the time of consolidation of land. Amar Nath Dubey and Raj Nath Dubey sons of Kanhai filed an objection for recording their name over ½ share of the disputed land along with the respondents.

The respondents contested the objection on the ground that Kanhai son of Kishun was unmarried and died issueless. His share in the land in dispute was inherited by them, who are sons/grandsons of Bechai, his brother. The petitioners were not the sons of Kanhai. They had earlier filed an objection during consolidation of land in which it has been held that Jagannath, Amar Nath and Raj Nath were illegitimate sons of Kanhai and not entitled to inherit. It was further held that the respondents were the heirs of Kanhai. The judgments of consolidation authorities in the previous proceedings operate as *res judicata* between the parties and the objection of the petitioner was liable to be dismissed on this ground alone.

The stand of the petitioners was that the previous proceedings would operate as *res judicata* in respect of issues of facts alone but not in respect of a pure issue of law as to whether illegitimate sons of a Brahmin person were entitled to inherit the property of his father or not. The petitioner accepted the finding of fact in respect of Jagannath, Amar Nath and Raj Nath being the illegitimate sons of Kanhai but disputed the other finding that in law such illegitimate sons cannot inherit the property of their father. The previous judgment on this legal issue was disputed by the petitioners. According to them decision on such pure issues of law could not operate as *res judicata* in respect of other properties which were not subject matter of the earlier proceedings before the Consolidation Authorities.

The High Court agreed to the stand of petitioner that findings relating to the facts that the petitioners are illegitimate children of Kanhai would operate as *res judicata* but so far as findings on issues of law would not operate as *res judicata* in subsequent proceedings in respect of other properties.

The Hon'ble Apex Court observed that the distinction drawn by the High Court in the impugned judgment that an erroneous determination of pure question of law in a previous judgment will not operate as *res judicata* in the subsequent proceeding for different property though between the same parties is clearly in accord with section 11 of the CPC. Strictly speaking, when the cause of action as well as the subject matter i.e., the property in issue in the subsequent suit are entirely different, *res judicata* is not attracted and the competent court is therefore not debarred from trying the subsequent suit which may arise between the same parties in respect of other properties and upon a different cause of action. In such a situation, since the Court is not debarred, all issues including those of facts remain open for adjudication by the competent Court and the principle which is attracted against the party which was lost in an important issue of fact in the earlier suit is the principle of estoppel, more particularly "issue estoppel" which flows from principles of evidence such as Sections 115, 116 and 117 of the Indian Evidence Act, 1872 and from principles of equity. As a principle of evidence, estoppel is treated to be an admission or in the eyes of law something equivalent to an admission of such quality and nature that the maker is not allowed to contradict it. In other words it works as an impediment or bar to a right of action due to a affected person's conduct or action. "Estoppel by judgment" finds reference in the case of *Ahsan Hussain Abdul Ali Bohari, Proprietor Abidi Shop vs. Maina W/o Nahi Telanga AIR 1938 Nag. 129.* It is taken as a bar which precludes the parties after final judgment to re-agitate and re-litigate the same cause of action or ground of defence or any fact determined by the judgment. If the determination was by a Court of competent jurisdiction, the bar will remain operative even if the judgment is perceived to be erroneous. If the parties fail to get rid of an erroneous judgment, then persons claiming through them must remain bound by it.

The Apex Court further relied on the decision of *Mathura Prasad Sarjoo Jaiswal (AIR 1971 SC 2355),* wherein it was held that where the decision is on pure question of law then a Court cannot be precluded from deciding such question of law differently. Such bar cannot be invoked either on principle of equity or estoppel. No equitable principle or estoppel can impede powers of the Court to determine an issue of law correctly in a subsequent suit which relates to another property founded upon a different cause of action though parties may be same. As explained earlier, in such a situation the principle of *res judicata* is strictly speaking not applicable at all. So far as principle of estoppel is concerned, it operates against the party and not the Court and hence nothing comes in the way of a competent Court in such a situation to decide a pure question of law differently, if it so warranted. The issues of facts once finally determined will however, stare at the parties and bind them on account of earlier judgments or for any other good reason where equitable principles of estoppel are attracted.

Satyendra Kumar and Others vs. Raj Nath Dubey and Others AIR 2016 Supreme Court 2231

2. Son – Definition – includes adopted son – In Inheritance claim not mentioning adopted son – Adoption deed summoned from office of sub registrar which is public document registered more than forty years ago –Admissible in evidence – Amendment application under O. 6, R. 17 Civil P. C. seeking claim of being adopted son – Not necessary. General Causes Act Section 3(57)

The appellant is the son and only legal heir of Hira Lal and Kesar Devi, both of whom have died interstate. It is further stated that Hira Lal had a brother named Mahadev Prasad and both these brothers were having agricultural land situated in Municipal Corporation of village Gospura. It is further stated that after the demise of Hira Lal and Mahadev Prasad as well as wife of Mahadev, the appellant is the only legal heir who has right to inherit the aforesaid properties inasmuch as Mahadev Prasad died issueless. It is further claimed that the respondent herein has no right or concern in any manner whatsoever, in the aforesaid properties which was left by deceased Hira Lal and Mahadev Prasad. The Respondent contested the aforesaid suit filed by the appellant on the ground that appellant was not the son of Hira Lal and moved an application for conducting DNA test to prove the same. This application was dismissed by the Trial Court. Thereafter, the appellant moved an application for amendment of the plaint, under Order VI Rule 17 of the Civil Procedure Code taking a specific stand therein that he was the adopted son of late Hira Lal. During proceedings, in order to prove that the appellant was the adopted son of late Hira Lal, the appellant summoned the record of the sub-registar to bring on record adoption deed dated 29-3-1974. When the official of the office of the sub-registrar came with the record to the Court, the respondent raised objection to the admissibility of the said adoption deed on the ground that it was beyond the pleadings and therefore could not be admitted as evidence.

The Hon'ble Supreme Court observed that once the plaintiff has mentioned in the plaint that he was the only son of late Hiram Lal, it was not necessary for him to specifically plead that he was an adopted son. Section 3(57) of the General Clauses Act, 1897 defines 'son' as under:"'Son' in the case of any one whose personal law permits adoption, shall include an adopted son."Once the law recognises adopted son to be known as son, it was not necessary for the appellant to plead that he was the adopted son. His averment to the effect that he was the only son, would be sufficient to lay the claim of inheritance on that basis. No doubt, the respondent has denied the appellant being the son of late Hira Lal. It is for this reason the adopted son and in support of this plea, the appellant had summoned the original of adoption deed dated 29-3-1974 from the office of sub-registrar.

It was also observed that in support of his claim, the appellant is relying upon a document which is a public document and was purportedly registered more than 40 years ago, i.e., in the year 1974. There was no justifiable reason for the Trial Court to reject the aforesaid plea in view of the provisions of section 3(53) of the General Clauses Act. In fact, it was not even necessary for the appellant to move an application under Order VI Rule 17 of the Code of Civil Procedure, 1908, with an attempt to take a

specific plea that he was the adopted son as, we say at the cost of repetition, his plea to the effect that he was the son of late Hira Lal was an adequate plea and to prove that he was the son, he could also place on record the document, i.e., the adoption deed in the instant case, to show that he was the adopted son. The Court allow this appeal by setting aside the impugned judgment of the High Court as well as the order of the Trial Court refusing to admit the document, i.e the adoption deed dated 29-3-1974, in evidence. The appellant shall be permitted to summon the said record again.

Pawan Kumar Pathak vs. Mohan Prasad AIR 2016 Supreme Court 2155

3. Power of Attorney – Power of attorney holder is not entitled to plead on behalf of principal, but he can only lead evidence or settle pleading in form of plaint or written statement or petition – Hence, mother of wife executed with power of attorney cannot enter into compromise for dissolution of marriage: Power of Attorney Act, Section 2

Applicant was seeking divorce on mutual consent. Though dates were fixed by the Court, however, the matter could not be taken for hearing, finally the applicant left the country for Boston, USA for pursuing her carrer. The applicant executed power of attorney in favour of her mother and to enter into a compromise for dissolution of marriage before Family Court. The applicant filed an application through her counsel and prayed for decision of the case but the application was rejected. The learned Court noted in the impugned order that merely on the basis of an affidavit, the marriage cannot be dissolved in proceedings under section 13B of the Act, 1955. The presence of the parties is necessarily mandatory, further, the electronic facility available in the Court cannot be used, as there being no device for interacting with a party who is residing outside the country.

The Allahabad High Court observed that the expression "Power of Attorney" has been defined in the Strouds Judicial Dictionary as an authority whereby one "is set in the turn, stead, or place of another" to act from him.

The term "Power of Attorney" indicates a power of authority under seal. A "Power of Attorney" is an instrument in writing by which one person, as principal, appoints another as his agent and confers upon him the authority to perform certain specified acts or kinds of acts on behalf of the principal. One has to bear in mind the distinction between all such actions, which are liable to be performed by a person in his individual capacity as distinct from those, which are liable to be performed in exercise of statutory duty or function or such actions, which are liable to be regulated by a statute itself.

It was further observed that an agent is always allowed and permitted to make and set forth the pleading on behalf of his principal in India. Therefore, deposing on behalf of the principal in a Court being part of exercise of tendering evidence is not a forbidden exercise to be indulged in by an Agent. Such person are entitled to be cross examined as the act and art of cross-examination being essentially to ascertain the veracity of the statement/submissions made by a witness and in that process, extract the whole of the truth. Section 18

of the Evidence Act, clearly permits and allows evidence to be collected even from an agent.

The Power of Attorney holder is not entitled to plead on behalf of the principal, but he can only lead evidence or settle the pleading in the form of a plaint or written statement or petition. In view of the above the Court accordingly held that a general Power of Attorney can depose and also lead evidence on behalf of his principal.

Smt. Shilpa Chaudhary vs. Principal Judge and another AIR 2016 Allahabad 122

4. Company unable to pay debts – Winding up directed by Company Court – Thereafter a reference before Board of Industrial and Financial Reconstruction – Pleaded all proceedings in respect of the company ought to have been stayed in terms of Section 22 of the SICA – Held the provisions of the SICA would prevail over the provisions of the Companies Act : Sick Industrial Companies (Special Provisions) Act, 1985 Sec.22

Petition was filed by Madura Coats in the Allahabad High Court for winding up Modi Rubber on the allegation that Modi Rubber was unable to pay its huge undisputed debts. After two years of adjournments, the Company Court declined to grant any further adjournment to Modi Rubber. On consideration of the material on record the Company Court passed an order on 12th March, 2004 holding that Modi Rubber was unable to pay its undisputed debts and that it was just and equitable that the company be wound up. An Official Liquidator was appointed to take charge of the assets of the company and to submit a report along with the inventory. Feeling aggrieved by the winding up order, Modi Rubber preferred an appeal before the Division Bench of the High Court which was allowed by the impugned judgment. Before the Division Bench it was brought out for the first time that on 6th December, 2003 the Board of Directors of Modi Rubber had passed a resolution to file a reference before the Board of Industrial and Financial Reconstruction ('the BIFR') under the provisions of the Sick Industrial Companies (Special Provisions) Act, 1985 ('the SICA').

Pursuant to the aforesaid resolution, an application was made by Modi Rubber to the BIFR on 3rd February, 2004 which was received by the BIFR on 4th February, 2004. Thereafter, the application was scrutinised and on 17th March, 2004 the reference made by Modi Rubber was registered as Case No. 153 of 2004. It will be seen that while the application for making a reference was sent to the BIFR before the winding up order was passed by the Company Court, the reference was actually registered after the winding up order was passed by the Company Court.

It was contended by Modi Rubber on filing an application before the BIFR, all proceedings in respect of the company ought to have been stayed in terms of Section 22 of the SICA. Consequently, even the Division Bench of the High Court could not have decided the appeal filed by Modi Rubber. This contention was rejected by the High Court and it was held that the crucial date for a stay of proceedings under Section 22 of the SICA is the date on which the reference is registered with the BIFR and not the date

on which an application for reference is filed. However, the High Court took into consideration the subsequent events namely the fact of registration of the reference and directed that the proceedings before him shall remain in abeyance till the disposal of proceedings before the authorities under the SICA.

The Supreme Court observed that the correctness of the impugned judgment and order will need to be tested on these facts and the law placed before us in connection with the reference made to the Larger Bench. On perusal of the facts the Court was of the opinion that different situations can arise in the interplay between the Companies Act and the SICA in the matter of winding up of a company and these situations have already been dealt with by the Court at one time or another.

It was further observed, once a reference is registered after scrutiny, it is mandatory for the BIFR to conduct an enquiry. It was also held that the SICA is intended to revive and rehabilitate a sick industry before it can be wound up under the Companies Act. The legislative intention is to ensure that no proceedings against the assets of the company are taken before any decision is taken by the BIFR because if the assets are sold or the company is wound up, it may become difficult to later restore the *status quo ante*. It was held that it is for this reason that the enquiry under Section 16 of the SICA must be treated to have commenced as soon as the registration of the reference is completed after scrutiny and that action against the company's assets must remain stayed in view of Section 22 of the SICA till a final decision is taken by the BIFR.

In so far as the present case, the Supreme Court does not find any error in the view taken by the High Court in concluding that the winding up proceedings before the Company Court cannot continue after a reference has been registered by the BIFR and an enquiry initiated under Section 16 of the SICA. The present appeal is squarely covered by the primacy given to the provisions of the SICA over the Companies Act as delineated in Real Value, Rishabh Agro and Tata Motors. Consequently, the High Court was right in concluding that the provisions of Section 22 of the SICA would come into play and that the Company Court could not proceed further in the matter pending a final decision in the reference under the SICA

Madura Coats Limited vs. Modi Rubber Ltd. [Civil Appeal No. 1475 of 2006 dated 29-6-2016 (SC)]

5. Hindu Law – Daughters right – Law of retrospective and prospective – Coparcenary rights of daughters in a joint Hindu Family – Being property not partitioned or alienated of their father applies only if both the father and the daughter are alive on the date of commencement of the Amendment Act – Hindu Succession (Amendment Act), 2005 which came into effect on 9-9-2015

The suit properties were acquired by the plaintiff from her late father Yeshwanth Chandrakant Upadhye by inheritance from his adoptive mother Smt. Sunanda Bai. After the death of her father on 18th February, 1988, she acquired the share in the property as claimed. The suit was contested mainly

with the plea that the plaintiff could claim share only in the self-acquired property of her deceased father and not in the entire property. During pendency of the suit, the plaintiff amended the plaint so as to claim share as per the Amended Act 39 of 2005.

The Karnataka High Court had held that daughters would be entitled to equal share even if father had died prior to September 9, 2005, when litigations over partition were pending in Courts. The defendants – appellants have questioned the Judgment of the High Court with the contention that the amended provision of Section 6 has no application in the present case. Father of the plaintiff died on 18th February, 1988 and was thus, not a coparcener on the date of commencement of the Amendment Act. The plaintiff could not claim to be "the daughter of a coparcener" at the time of commencement of the Act which was the necessary condition for claiming the benefit. The amendments of 2005 gave equal right to daughters in coparcener properties by removing the discrimination that existed in the original enactment, the Hindu Succession Act, 1956 against Hindu women on rights over ancestral properties.

The Hon'ble Supreme Court observed that the text of the amendment itself clearly provides that the right conferred on a 'daughter of a coparcener' is 'on and from the commencement of Hindu Succession (Amendment) Act, 2005'. Section 6(3) talks of death after the amendment for its applicability. In view of plain language of the statute, there is no scope for a different interpretation than the one suggested by the text of the amendment. An amendment of a substantive provision is always prospective unless either expressly or by necessary intendment it is retrospective. In the present case, there is neither any express provision for giving retrospective effect to the amended provision nor necessary intendment to that effect. Requirement of partition being registered can have no application to statutory notional partition on opening of succession as per unamended provision, having regard to nature of such partition which is by operation of law. The intent and effect of the amendment will be considered a little later. On this finding the view of the High Court cannot be sustained. Contention of the respondents that the amendment should be read as retrospective being a piece of social legislation cannot be accepted. Even a social legislation cannot be given retrospective effect unless so provided for or so intended by the legislature. In the present case, the legislature has expressly made the amendment applicable on and from its commencement and only if death of the coparcener in question is after the amendment. Thus, no other interpretation is possible in view of express language of the statute.

Accordingly, the Supreme Court held that the rights under the amendment of 2005 are applicable to living daughters of living coparceners as on 9th September, 2005 irrespective of when such daughters are born.

Prakash & Ors. vs. Phulvati & Ors. Civil Appeal No.7217 of 2013 dated 16/102015 (SC)

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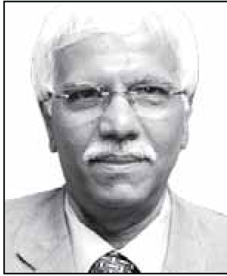

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ECONOMY AND FINANCE

RESILIENCE AFTER BREXIT

The future is difficult to predict and similar is the case of the thought process of human beings. It is widely believed that Brexit created a great risk, not only to the United Kingdom and the European Union (EU) but even for the rest of the world. It would impact global trade and growth rates of various economies. On the eve of the result of the referendum on 23rd June, due to exit mandate by majority vote, the markets around the world collapsed substantially. However, they bounced backed immediately. Many thought that the bounce back was temporary but they were proved wrong. In spite of the risks emerging out of Brexit, the global stock markets have advanced well in the month of July. The directly affected London Stock Exchange Index appreciated by 2% and the stock markets in Germany, which is the leading economy in EU, have appreciated by more than 6% in the month. It seems that liquidity has become king and is driving the global markets upward without adequately supporting economic fundamentals in many cases. Time will only tell whether this is a bubble or a sustainable rally.

The US economy continued to grow well during the month. Though the FED meeting did not raise benchmark interest rates, the outlook was quite optimistic. Now a fresh thought is emerging that the US may start increasing interest rates during the current financial year. Some optimistic people are expecting more than one rate hike, as low interest rates for too long a period may turn out to be detrimental to the economy. The risk to the US economy in spite of Brexit is appearing not too significant and that may result in a rate hike. However, the event may have negative repercussions on the other countries and specially on the emerging markets. The US presidential elections may appear to be a domestic issue of the country but has lot of repercussions across the world. The effect is not only financial but it may affect many issues such as terrorism, world peace, military balance and even political equations across regions. The developments in the remaining part of 2016 may turn out to be quite important for the overall safety and well-being of the world.

Europe seems to be in not such a good spot but the stock markets therein are still in frenzy. Unfortunately, currently Europe is also suffering from terrorism which can risk tourism in the region and can affect many economic parameters. The inflow of refugees is bringing in risks of various types and can have political backlash in various parts of the region. The United Kingdom's exit from the EU can instigate more referendums in other countries in the Union, which harbour dissatisfied elements regarding being in the Union. Any negative vote, specially by a country which is using Euro as its currency, may further weaken the Union. Woes of Europe seem to be far from over. Ensuing times can be more difficult though the

European Central Bank and the major economies in the Union are not leaving any stone unturned to accelerate the sagging growth in the region.

There is hardly any change in the economic outlook of China and Japan. Their difficulties persist and various solutions applied are not yielding desired results. The issues are structural and may not be corrected easily. The growth of Asia Pacific region can also suffer due to this phenomenon.

Many global economists are talking positive about India and its growth story. GST reforms have started taking shape though lot more things are yet to be done for starting GST regime in India. The sentiment is quite positive and it has pushed up stock markets. Government believes that the economic outlook of India is very positive and it is being brought to notice of the subjects in order to improve the sentiment. The exercise has given positive psychological impact to an extent. However, many investors are not sure whether the sentiments have overtaken the fundamentals at this juncture. The onset of a good monsoon has also aided to improve the sentiments. After a couple of years of tardy agricultural growth, India may achieve a bumper Kharif harvest this year and that may help to control the retail inflation, which bothers most of the citizens. It may pave a way to reduce benchmark interest rate by the Reserve Bank of India, which probably the Government believes to be long overdue. Things are positive but expectations may be running higher. Such a situation creates a risk of disappointment, which can be detrimental to the sentiments. As of now, this risk seems to be real. Though the internal environment in India is quite positive, growth also depends on many external factors. How conducive they can remain and for how long is a question. This risk is not easily manageable and far from eliminable. We can only hope and pray that our country withstands these risks. The major positive development of the month is that the crude prices have again started easing. It will be of great advantage for India, if they remain in the current range of 40 to 45 USD in the months to come. Low crude prices can control the trade deficit of the country, which is affected by the global prices of crude oil.

The Indian stock markets were very bullish in the month aided by global rise in equity prices as well as positive domestic developments on GST issue. The rally took stock markets up by more than 4%, in spite of uncertainties. The sentiment was positive and global events could not deter the rally, which was fuelled by large injection of funds by Foreign Institutional Investors (FIIs). They pumped in about ` 10,000/- crore during the month in the Indian equity markets. The rally was more pronounced in mid-cap and small-cap stocks. In spite of looming risks, the bank stocks gained substantial ground. This has made the valuation of Indian stock markets rise substantially and the index made 52 weeks high. Though Indian markets are fancied by global investors as having substantial potential, the overall stock prices are not cheap. Lot of positives are already factored in the stock prices and more evidence will be needed for the stock markets to sustain the momentum. Good progress of monsoon is quite a positive development, which can not only improve GDP but can also increase consumption by rural India. The payout of 7th Pay Commission recommendations can also increase consumption aiding economic activities in the country. The stock prices might have already factored in this good news. The results season is still on and there is a likelihood of negative surprises cropping up in the month of August. Therefore, the upside for the current month looks limited and a correction making the stocks cheaper by about 5% over the next couple of months, cannot be ruled out. Investors should exercise caution in adding to stock portfolio at the current levels and only selective purchases may be made. Part profit booking may be considered. However, Systematic Investment Plans need not be aborted due to the high valuations.

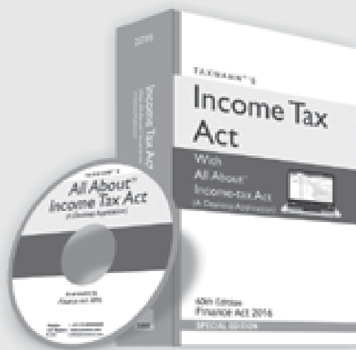
Globally, the Bond yields are coming down and India is no exception. As inflation is getting under control, there is a possibility of further reduction of benchmark interest rate in the months to come. The reduction is expected to be gradual and not aggressive as quick reduction of interest rates may increase the credit intake causing demand pushed inflation. The gradual reduction of interest rates seems to be the order of the day and the investors need to take their stand at the earliest, specially in respect of bond investments. While interest rate lowers, the bond prices may increase to adjust the yield rate. Fixed Deposit interest rates are also likely to ease out but, most likely, the process will be gradual.

News is being circulated that the sales of real estate was better in the last quarter ended in June, 2016 as compared to the earlier quarters. However, ground realities do not seem to have changed much across India. A recovery in the real estate market may be at a nascent stage and for it to take traction, the economy needs to grow fast and interest rates should come down. There is also oversupply in the market, which needs to get absorbed. Therefore though the property market will start improving, improvement in prices will take some time. Investors may tread cautiously in this asset class.

Over the last few years, many developers have issued various types of instruments, which yield high rate of return ranging between 18-24%. These instruments are high risk instruments and that is why they are fetching high returns. There was a time when real estate business used to earn substantial profits and therefore the developers could offer and afford high returns to their investors. Gone are those good times and the construction industry is facing a severe pressure due to high cost and low demand. It has reduced its capacity to pay high returns to investors. Therefore, the affordability of high returns to investors on such instruments is a question. Investors need to be cautious in investing in such instruments or lending money to developers or booking properties while under lower stages of construction.

Recently, an uncommon phenomenon has emerged. Over the last few months, certain asset classes which have negative correlation with each other have started appreciating simultaneously. While stock markets and dollars are appreciating, generally precious metal like gold depreciates. However, in recent times even gold has appreciated along with strong stock market and steady dollar. Such a phenomenon may cause concern to investors as these uncommon correlations can lead to structural imbalances and even asset bubbles. Something seems to be happening differently as compared to the past experience and therefore investors need to be cautious. The world is currently harbouring excessive liquidity pumped by central banks of developed countries for avoiding recession and holding on to economic growth. It is likely that every central bank might have taken a calculative decision for the good of their economy but together they have increased global risks of causing asset bubbles. Therefore, investors need to be careful, specially dealing with international assets.

Domestic story of India seems to be better than most other parts of the world and therefore, interest of foreign investors in Indian markets is increasing. India has better opportunities but the northward journey of its economy may not be as smooth as expected. There could be some upheaval due to unexpected international events causing turmoil. Investors should devise and follow such strategies, which can take on to such storms and sail smoothly through them.



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The Chamber News

Important events and happenings between 8th August, 2016 to 8th September, 2016 are being reported as under.

I. Admission of New Members

1) The following new members were admitted in the Managing Council Meeting held on 2nd August, 2016.

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15	Ms. Gupta Ananya Atindra	Advocate	Mumbai
16	Mr. Angre Nitin Dattatraya	Advocate	Thane
17	Mr. Shah Ankit Pradeep	CA	Thane

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1	M/s. ASQUARE	Mumbai
2	M/s. AAA Business Consulting Pvt. Ltd.	Thane

II. Past Programmes

1. DIRECT TAXES COMMITTEE

The **Direct Tax Update Series Lecture on "Income Declaration Scheme 2016 – Provisions and Issues"** was held on 5th August, 2016 at Walchand Hirachand Hall, IMC. The Lecture meeting was addressed by Ms. Nishi Singh, Member of CBDT, Shri D. S. Saksena, Principal of CCIT, Mumbai, Shri D. C. Patwari, Principal, CIT, Mumbai and Dr. K. Shivaram, Sr. Advocate and Past President. There was interaction session of Question and Answers on Income Declaration Scheme-2016.

2. LAW & REPRESENTATION COMMITTEE

REPRESENTATIONS:

A) Representation on **"Companies Amendment Bill 2016"** on 12.7.2016 before Parliamentary Standing Committee on Finance which was chaired by **Shri Veerappa Moily** at Trident Hotel Nariman Point.

CTC Team was represented by CA Hitesh R. Shah, President and CA Hinesh Doshi, Hon. Jt. Secretary, CA Paras Savla, Co - Chairman of Law and Representation Committee, CA Jayesh Gandhi, Member.

B) Representation on **"Settlement of Dispute Scheme under MVAT**" before the Commissioner of Sales Tax, Maharashtra on 5th July, 2016

III. Future Programmes

(For details of the future programmes, kindly visit www.ctconline.org or refer The CTC News of August, 2016)

1. DIRECT TAXES COMMITTEE

The **Full Day Seminar on "Recent Changes in Assessment Procedures"** will be held on 19th August, 2016 at Babubhai Chinai Committee Room, IMC.

2. INTERNATIONAL TAXATION COMMITTEE

A. The **Full Day Seminar on "Non-Resident Taxation and FEMA Implications"** will be held on 3rd September, 2016 at Hotel West End, New Marine Lines, Mumbai.

B. The **Basic Intensive Study Course on FEMA"** will be held on 14th, 15th, 21st and 22nd October, 2016 at Hotel West End, New Marine Lines, Mumbai.

3. MEMBERSHIP & PUBLIC RELATIONS COMMITTEE

The **Full Day Seminar on "Companies Law and Direct Tax Law Focus on Practical and Upcoming Issues"** jointly with Solapur WIRC Branch of ICAI and Solapur Tax Practitioner's Association will be held on 20th August, 2016 at Balaji Sarovar Hotel, Hotgi Road, Solapur 413003.

4. STUDENT & IT CONNECT COMMITTEE

The **"3rd Football Cup"** jointly with Membership & Public Relations Committee will be held on 27th August, 2016 at Indian Football School, Cooperage Football Ground – Mini Ground, Colaba, Mumbai.

5. DELHI CHAPTER

The Full Day Seminar on "Insolvency and Bankruptcy Law – Emerging Issues, Challenges and Professional Opportunities" will be held on 27th August, 2016 at India International Centre, New Delhi – 110 003.

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DIRECT TAXES COMMITTEE

Intensive Study Group on Direct Taxes Meeting on "Issues arising from Income Disclosure Scheme, 2016" held on 18th July, 2016 at CTC Office

CA Ashok Mehta addressing the members

MEMBERSHIP & PUBLIC RELATIONS COMMITTEE

Half Day Seminar on Real Estate Law & GST over view held on 16th July, 2016 at Nashik

Mr. Kirti J. Hakani, Advocate addressing the delegates

CA Pranav Kapadia addressing the delegates

STUDY CIRCLE & STUDY GROUP COMMITTEE

Study Group Meeting on "Recent Judgments under Direct Taxes" held on 8th July, 2016 at Babubhai Chinai Committee Room, IMC.

Mr. Vipul B. Joshi, Advocate addressing the members

Ms. Priti Shukla Advocate addressing the members

Study Group Meeting on the subject "Recent Judgments under Direct Taxes" held on 4th August, 2016 at Eros Theatre Building, Churchgate.

CA Anish Thacker addressing the members.

CA Harsh Kapadia addressing the member.

INDIRECT TAXES COMMITTEE

Study Circle Meeting on "Recent Decisions under Service Tax Laws" held on 20th July, 2016 at Babubhai Chinai Committee Room, IMC

CA Keval Shah addressing the members. Seen from L to R: S/Shri CA Atul Mehta, Convenor, CA Vikram Mehta, Chairman, CA Hitesh R. Shah, President and Sumit Jhunjhunwala, Convenor.

INTERNATIONAL TAXATION COMMITTEE

Programme on "Tax Implications of EPC Contracts, Indirect Transfer and Real Estate Funds – Case Studies" held on 3rd August, 2016 at CTC Conference Room

CA Vishal J. Shah addressing the members

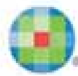
Transfer Pricing Study Circle Meeting on "Intra Group Services & Management Fees" held on 18th July, 2016 at CTC Office

CA Darshak Shah addressing the members

THE CHAMBER'S JOURNAL

Posted at the Mumbai Patrika Channel
Sorting Office, Mumbai 400 001.
Date of Posting: 16th of Every Month

No. MCS/149/2016-18
R.N.I. No. MAHENG/2012/47041
Date of Publishing 12th of Every Month



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Printed and Published by Shri. Kishor D. Vanjara on behalf of The Chamber of Tax Consultants, 3 Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020 and Printed at Finesse Graphics & Prints Pvt. Ltd., 309 Parvati Industrial Premises, Sun Mill Compound, Lower Parel (W), Mumbai - 400 013. Tel: 4036 4600 and published at The Chamber of Tax Consultants, 3, Rewa Chambers, Ground Floor, 31, New Marine Lines, Mumbai - 400 020.