KSCAA NEWS BULLETIN

2014 - 15 Embodiment of Virtues

Upholding the Moral & Professional Excellence

English Monthly
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Happy New Year 2015

Sincerely thank the founders and mentors of KSCAA on this 57th Founders' day

International Tour

INDONESIA – BALI – MALAYSIA 6 Days / 5 Nights

from 3rd to 9th February 2015

BASAVANAGUDI CPE STUDY CIRCLE

CPE Workshop on

TDS PROVISIONS AND REASSESSMENT PROCEDURES-PRACTICAL ISSUES

Saturday, 20.12.2014
Time: 3.45 PM to 8.00 PM

CPE 4 Hrs

Details Inside

SPORTS AND TALENT MEET

21st December 2014
Sunday

From the President

ಬಲ್ಲವರು ನುಡಿದುದು
ಬದಲಾವಣೆಯೇ ಜಗದ ನಿಯಮ,
ಮೋಡದಿ ಕಾಲೂರಿ ನಡೆಯುವುದು
ಇನ್ನೊಂದು ಆಯಾಮ,
ಈ ಹೊಸ ವರುಷದಂದು
ಒಂದು ಮಹೋನ್ನತ ಬದಲಾವಣೆಯು
ನಿಮ್ಮದಾಗಲಿ, ಎಂದು ಹಾರೈಸುವ....

Dear Professional Colleagues,

Karnataka MobileOne, the much anticipated initiative from the state government was launched at Bengaluru, on Monday, 8 December. The multi-mode mobile governance service could be accessed both on feature phones and smartphones, including on iOS and Android platforms. It reportedly brings over 4000 services, including 637 government services & 3,644 private services right to the citizens' fingertips thru mobile app. People can access various services at all time and throughout the year. They can book railway and government transport bus tickets, pay property tax and utility bills (electricity, water, phone etc..), file income tax, apply driving license, file m-passport and more making it the country's and also the world's largest multi-mode mobile governance platform.

A debate has begun in Delhi on a Gujarat notification making voting compulsory in local elections, with supporters urging a similar move at the national level and critics' arguing it's a violation of citizens' freedom. It was observed that due to low turnout of voters to discharge their duty by exercising their right to vote, the true spirit of the will of the people is not reflected in the electoral mandate. Compulsory voting will enable people to be more aware about their local bodies and administrative system and would help in reducing the corruption and purchase of vote.

The recently concluded G20 Summit acknowledged that corruption continues to represent a significant threat to global growth and financial stability. It destroys public trust, undermines the rule of law, skews competition, impedes cross-border investment and trade, and distorts resource allocation. The summit reaffirmed its commitment to building a global culture of intolerance towards corruption. The action plan outlined includes ensuring transparency of beneficial ownership, combating bribery through effective criminal and civil laws and enforcement, private and public sector transparency and integrity and international cooperation. We urge members to participate positively in reducing the corruption from our system and business.

Talking about our profession, we heaved a sigh of relief with the annual income tax filing season for AY 2013-14 coming to an end. And K-VAT annual Form 240 certification and filing should be completed by the end of this month. To enrich the members' knowledge on TDS Provisions & Reassessment Procedures, Basavanagudi CPE Study Circle is organizing a CPE workshop on **"TDS Provisions and Reassessment Procedures-Practical Issues"** on 20th December 2014 at Sri Bhagwan Mahaveer Jain College Bengaluru and request the members to make use of this opportunity & enrich their knowledge.

KSCAA, jointly with Bangalore Branch of SIRC of ICAI, is organising a Cricket Tournament for members on 14th December 2014 and Sports and Talent Meet for members and family on 21st December, 2014. The details are provided elsewhere in this news bulletin. We invite all members to participate with their family and enjoy the events.

An International Study Tour to Indonesia, Bali and Malaysia has been organised by Bangalore Branch of SIRC of ICAI jointly with other branches of SIRC of ICAI in Karnataka and Karnataka State Chartered Accountants Association from 3rd to 9th February 2015. The details, about the tour have been provided elsewhere in the news bulletin. Members may make use of the opportunity and confirm your bookings before 25th December 2014.

To encourage and increase the KSCAA membership, from last month, we have started a Membership Drive on every 3rd Saturday of the month. This month, KSCAA membership drive has begun from Kalaburagi. We thank the members of Kalaburagi for responding to our initiatives and we promise to serve better for their needs in profession. We request the members to encourage the other ICAI members in the state to be part of KSCAA.

Preparations for the KSCAA 27th Annual conference has begun with a meeting of senior members and mentors of our association on 6th Dec, 2014 to decide on the topics, speakers and resources etc.

As New Year going to start, I wish good times live on in our memories and may we learn lessons from the troubling times that will make us stronger and better than ever. KSCAA extends its heartiest & warmest greetings to all the members on the eve of Christmas and New Year 2015 and wish them and their family health, happiness, prosperity and advancement in the professional endeavours. It is time to enjoy the winter chill and ring in the New Year.

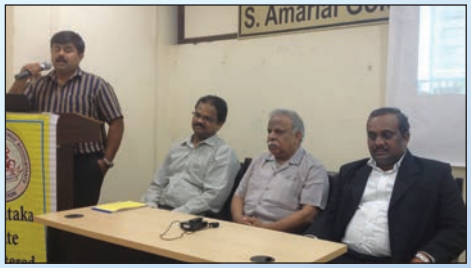
I take this opportunity to place on record our sincere gratitude to the founders and mentors of KSCAA on this 57th founders' day and pledge our continued commitment to KSCAA and our profession.

Wish you happy and Prosperous New Year 2015

In service of the Profession,

CA. Raveendra S. Kore
President

CPE Workshop on Practical Problems In Filing Company Forms –ADT1 & MGT14 at Association Premises



Dignitaries on the dais

CA. Prashanthkumar N.

Cross section of participants

KSCAA Membership drive begins at Kalaburagi

CA. Altaf Baligar, CA. Basavaraj Patil, CA. Shrikant Nironi, CA. Malakajappa Biradar

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KSCAA welcomes articles & views from members for publication in the news bulletin / website.

email: info@kscaa.co.in

Website: www.kscaa.co.in

Operational Lease - Off Balance Sheet Item

CA. S. Krishnaswamy

One of the important of f Balance Sheet items is 'lease' when an asset is taken as on 'operational lease'- be it buildings, vehicles, plant and machinery or any other business asset. When the entity cannot afford to buy the assets, opts take on lease the required assets without ownership, the disclosure of terms of the lease, accounting, tax implications, assume importance in the context of mandatory, accounting standard (AS 19)

The key terms are defined in AS19:

- Lease
- Finance Lease
- Operating Lease
- Non-Cancelable Lease
- Inception of the Lease

A lease has both accounting and taxation issues. To buy or lease is a management decision.

Definitions of Key Terms:

1. A lease is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.
2. A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset.
3. An operating lease is a lease other than a finance lease.
4. A non cancellable lease is a lease that is cancellable only:
   a. Upon the occurrence of some remote contingency; or
   b. With the permission of the lessor; or
   c. If the lessee enters into a new lease for the same or an equipment asset with the same lessor; or
   d. Upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.
5. The inception of the lease is the earlier of the date of the lease agreement and the date of a commitment by the parties to the principal provisions of the lease.

Classification of Leases

As19 deals with classification of lease in Para 8. It gives examples of a finance lease-situations and indicators of situations; operating leases are dealt with in Para 23. The accounting and disclosure requirements are set out.

Expense Out

Para:23 Lease payments under an operating lease should be recognised as an expense in the statement of profit and loss on a straight line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Recognition

Para 24: For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognised as an expense in the statement of profit and loss on a straight line basis unless another systematic basis is more representative of the time pattern of the user's benefit, even if the payments are not on that basis.

Disclosures

Para 25: The lessee should make the following disclosures for operating leases

(a) the total of future minimum lease payments under non cancellable operating leases for each of the following periods:
   (i) not later than one year;
   (ii) later than one year and not later than five years;
   (iii) later than five years;

(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the balance sheet date;

(c) lease payments recognised in the statement of profit and loss for the period, with separate amounts for minimum lease payments and contingent rents;

(d) sub-lease payments received (or receivable) recognised in the statement of profit and loss for the period;

(e) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:
   (i) the basis on which contingent rent payments are determined;
   (ii) the existence and terms of renewal or purchase options and escalation clauses; and
   (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt, and further leasing

Provided that a Small and Medium Sized Company, as defined in the Notification, may not comply with sub-paragraphs (a), (b) and (e).

Operating Lease Given Assets

Para 39: The lessor should present an asset given under operating lease in its balance sheet under fixed assets.

Sale and Leaseback Transaction

Para 50:If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any profit or loss should be recognised immediately. If the sale price is below fair value, any profit or loss should be recognised immediately except that, if the loss is compensated

by future lease payments at below market price, it should be deferred and amortised in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the excess over fair value should be deferred and amortised over the period for which the asset is expected to be used.

Fair Value

Para 52:For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value should be recognised immediately.

Taxation

1. If a lessee has obtained lease of vacant land and puts up a construction theiron can the expenditure be treated as 'revenue' and not as capital. A number of judicial decisions have analyzed the impact of such creation of buildings on a leasehold land:

   Case Law: Jayakrishna Flour Mills P.Ltd. V. Assistant Commissioner of Income-Tax[2014] 36ITR(Trib) 262(Chennai)

In this case the assessee is running a flour mill. In the assessment year under consideration, the assessee spent an amount of Rs.53,88,776 for the construction of storage shed on the leasehold land and claimed the same as expenditure in the profit and loss account. During the course of assessment proceedings, the Assessing Officer held that the sheds were constructed on lease-hold, therefore, the case of the assessee falls within the ambit of Explanation 1 to section 32(1) of the Income-tax Act, 1961 (hereinafter referred to as "the Act"). The amount spent by the assessee on construction of sheds is capital expenditure allowable for depreciation and is not revenue expenditure. The assessee submitted that four storage depots were allotted to the assessee on lease-hold basis for the period of twenty nine years in Integrated Storage-cum-Marketing Yard Complex by Tamil Nadu Foodgrains Marketing Yard Ltd., a special purpose vehicle formed by the Ministry of Commerce and Industry, Government of India. The assessee contributed for the construction of sheds. This did not result in creation of any asset or benefit of enduring nature to the assessee to secure lower monthly lease rents. A part from providing storage depot, the Tamil Nadu Foodgrains Marketing Yard Ltd. Is providing other facilities viz., warehouse, solar tunnel, dryer pro-processing centre, research and development laboratory, agri-business sourcing centre, cold storage unit, container terminal, training centre, etc. The land does not belong to the assessee and after the completion of lease period, the sheds shall be transferred to the lessor. Therefore, the amount contributed towards the construction of shed is a revenue expenditure, as no capital asset has come into existence. A perusal of the records shows that the assessee was allotted four yards for storage i.e open space provided by the Tamil Nadu Foodgrains Marketing Yard Ltd. Thus, there was no building or any structure in existence on the land in relation to which any renovation or extension or improvement or any similar work was carried out by the assessee. The hon'ble Madras High Court in the case of CIT v. TVS Lean Logistics Ltd. (2007) 293 ITR 432 (Mad) has held that Explanation 1 will not apply where there is no building. In the present case, the facts as emanating from records show that the assessee has not taken any buildings on lease.

Further, the assessee has stated that with the contribution for construction of sheds, the assessee shall be entitled to lower monthly lease rents. This fact has not been disputed by the revenue. The payment of lease rentals is revenue expenditure. Thus, the contribution made by the assessee initially would save revenue expenditure in the later years.

Thus, in the light of the judgments discussed above, it can be safely constructed that the expenditure incurred towards construction of sheds by the assessee is revenue in nature."

Decisions cited by Department

1. L. H. Sugar Factory and Oil Mills(P.) Ltd. V. CIT [1980] 125 ITR 293(SC)
2. CIT v. TVS Lean Logistics Ltd. (2007) 293 ITR 432 (Mad)
3. Indian Aluminium Co.Ltd.V.CIT [1992] 198 ITR 202 (Cal)

All the above decisions were distinguishable on facts, so held the High Court.

However, it will be seen than the issue is still a matter of controversy if the decisions cited by the department are considered where the facts show only veneer difference.

Issue

S 32(1) does not define capital expenditure. It only permits depreciation on building constructed leasehold land.

Explanation 1 to section 32(1), which was inserted by the Taxations Laws (Amendment and Miscellaneous Provisions) Act, 1986 with effect from April 1,1988, deals with the situations where the expenditure has been incurred by the assessee on construction of any structure on leasehold premises or lease hold building. Explanation 1 is reproduced herein below:

"Explanations 1.- Where the business or professions of the assessee is carried on in a building not owned by him but in respect of which the assessee holds a lease or other right of occupancy and any capital expenditure is incurred by the assessee for the purpose of the business or profession on the construction of any structure or doing of any work in or in relation to, and by way of renovation or extension of, or improvement to, the building, then, the provisions of this clause shall apply as if the said structure or work is a building owned by the assessee."

To fall within the ambit of Explanation 1 questions which are to be answered are:

(i) Whether the assessee is carrying on business or profession in a leased building or other rights of occupancy?

(ii) Whether the assessee has incurred any capital expenditure for the purpose of business on the construction of any structure or doing of any work in or in relation to and by way of renovation or extension or improvement in the building.

This section came up for interpretation in the case cited above.

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Audit Aspects under the Karnataka VAT Law - VAT 240

CA. G.B. Srikanth Acharaya and **CA. Annapurna D Kabra**

While VAT was introduced, it was predicted that there will be less procedures and compliance as it is based on self assessment. One of the objects and reasons for introduction of VAT is to make the levy of tax transparent. The law provides for subjecting the accounts to a VAT audit.

For K-VAT Purposes audit means scrutiny of the records of assessee and the verification of the actual K-VAT payments and receipts of inputs and capital goods provided with a view to check whether the assessee is paying the K-VAT correctly and following the K-VAT provisions and procedures. Rule 33 provides an elaborate listing of methodology of maintaining accounts and records. Under these circumstances it becomes necessary for the auditors to look into the assessee records under KVAT as well as own records to verify whether he is paying KVAT correctly and following laid down procedures. The Audit can be of various types like statutory audit, Procedures Audit, Internal Audit of K-VAT and CST transactions, Input Credit Audit (Inputs and capital goods Credit), legal compliance audit, review audit.

The KVAT Audit has various advantages to the Government or to the dealers like it is advantageous to the government by increasing the revenue, lesser cost of administration and collection, check on misclassification of goods to ensure the correct rate of tax and availment of input tax credit is as per law or not. It is beneficial to the Industry as it updates the assessee with respect to exemption, notification, clarification and circulars. After the introduction of VAT, almost all registered dealers will become taxpaying assesses. The assessing officers at their present strength cannot handle the increased assessment work that would result from all dealers becoming assesses under the VAT system. Necessarily there would be a system of self-assessment under which the return filed by all dealers will be accepted as such and the dealers deemed to be assessed on the basis of those returns. The basic simplification in VAT is that VAT liability will be self assessed by the dealers in terms of submission of returns upon setting off the tax credit. The correctness of self-assessment will be checked through a system of audit.

To prepare a meaningful audit report, the auditor must have sound knowledge of the relevant statutory requirement under the KVAT law. The audit notes and observations must be prepared in a systematic and methodological manner. These audit notes are the basis of drafting the report. These are some errors, which are committed accidentally due to lack of correct knowledge of accounting principles or statutory law. The auditor should use his professional judgment to rectify the accounting principles and statutory law followed by the dealer. Some audit observations require classification to ensure minimum legal requirements and some audit observations require auditor to make a qualification due to infringement of statutory requirements.

Generally the basic audit procedures include like verification of sales book, corresponding entries in the stock records should have been made, ensure that rates on which sales have been made are according to price list, sales return should be duly account for and stock should duly adjusted, ensure that goods sent on approval basis, goods sent on consigner are not recorded as sales, tally sales with sales tax returns, reconcile VAT collections with payments and transfer after adjusting the input tax credit, the net balance to appropriate accounts, Check adjustment of input tax by setting off against output tax by relevant journal entries, Check the different classification of sales at different of taxes as per schedule, Check the credit notes issued and reason for issue, Check the tax invoices, bill of sale prepared as per the Provisions of account, tally the monthly figures with the figures shown in the monthly return, Check the purchase invoices and proper classification of purchase is made at different rate of taxes, Purchase returns are accounted correctly, Check whether any stock is transferred to branches within the state and outside the state, Check whether capital goods are purchased, Ensure rebates and discounts have been adjusted properly etc

Section 31(4) of the KVAT Act 2003, states that every dealer whose 'total turnover' in a year exceeds rupees one Crore shall have his accounts audited by a chartered accountant or a cost Accountant or a Tax Practioner subject to such conditions and such limits as may be prescribed and shall submit to the prescribed authority a copy of the audited statement of accounts and prescribed documents in the prescribed manner.

The role of auditor in case of KVAT Audit is that he should obtain the knowledge of the business of the dealer by evaluating the internal control and assessing the audit risk. He has to conduct the audit as per audit plan and the audit programme. He should conclude the audit based on the audit evidence and report to the management. The auditor should be held liable for misstatement or non-detection of a material fact.

Although the provision under Sec 31(4) is not obligatory, the benefits of making the audit mandatory are considered to be of great significance for growth in trade and commerce industry. The burden on the department would reduce significantly because the dealers already audited under the mandatory audit need not be subjected to audit by the department. There is no prescribed manner in which the Audit under VAT has to be conducted. Rule 33 of KVAT Rule, 2005 has laid down that the audited statement of accounts shall be submitted in Form VAT 240 to the jurisdictional Local VAT officer or VAT sub-officer within nine months after.

The KVAT law has cast primary responsibility on the Auditors to verify the authenticity of books of Accounts maintained and the payment of the tax made by the dealer. The Auditors can be Chartered Accountant, Cost Accountant or Tax Practioner. They should basically verify whether the dealer has paid the taxes and availed the input tax credit by following the provisions and procedures as specified in KVAT law. The KVAT Audit Report (Form VAT 240) has been bifurcated between the Certificate and the report. A report is a formal statement usually made after enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. The contents of the KVAT Audit report is classified as general information, particulars of turnover, deduction and payment of tax and particulars of declaration and certificates.

Basically the audit requires meticulous planning, considering the volume of work, strict time line and nature of business of the dealer. The dealer can be trader, Manufacturer, Works contractor, lessee, retailer, Distributor or Agent, etc whose total turnover exceeds one Crore for the financial year. They have to file the Audit Report within nine months from the end of the financial year. The Due date for filing the KVAT Audit Report shall be 31st December 2014 for the financial year 2013-2014. In case the KVAT Audit Report is not filed within due date then the dealer shall be liable to pay the penalty of Rs. 5000/- plus Rs. 50/- per day under section 74(4) of the KVAT Act. Auditor should be updated with KVAT laws, CST laws, KTEG laws, applicable notification, exemptions, and circulars while conducting the audit. The auditor forms the opinion or conclusion based on the audit evidence and decides the matters, which are required to be reported and commented.

The paper writer in the following paragraphs will discuss the issues during the KVAT Audit and their views may differ with different schools of thoughts.

Revised Returns:

As per the KVAT law, the dealer is required to file the revised returns within six months from the end of the tax period. During the process of KVAT Audit, if there is a difference in sales, purchases, Input tax credit, set off credit, tax payable etc then the Auditor can incorporate the same in the Audit certificate with the reasons.

Payment of taxes

Due to the Audit, if there is an additional tax payable by the dealer then in such scenario the auditor can compute the taxes with interest and penalty and should declare in the Audit Certificate. The Payment of the taxes can be made along with the KVAT Audit Report accordingly.

Monthly Details

The KVAT Audit Report is the consolidated Report of all the transactions in a financial Year. The details of monthly transactions have to be enclosed along with the KVAT Audit Report for the better comparison of details as per books of Accounts and monthly return filed.

Statutory Forms

The KVAT Auditor has to verify the statutory forms obtained manually or electronically from the department under the KVAT law and CST law. The KVAT Auditor should verify the usage of such forms and the stock of unused forms lying as at the end of the financial year. But in case of sales or transfers against statutory forms, the dealer has to compute the difference tax liability due to non availability of the statutory forms and can comment on the same in KVAT Audit Report.

Classification of goods

It is an important aspect for computation of output tax liability and eligibility of input tax credit from the Audit point of view. In case the classification made by the dealer controversies with the classification made by the auditor then he has to comment on the same in the Audit Certificate. Even the matter pending before Commissioner or Appeal can be added in the report for the information of the VAT officer.

Financial statements

The Financial statements have to be enclosed along with the certificate and Report. The Audited financial statements have to be enclosed along with the certificate. Along with the Report as stated in Note to Part II, in case the trading account with the different classification of goods and profit and loss account and Balance sheet for transactions within state and outside state cannot be prepared then in such scenario the auditor can give his reasons for not filing the same and can enclose the trading account with sales and purchase at different rate of taxes for the local sales and interstate sales as made by the dealer.

Notices received from the department

The department might issue the notice before and after compliance of the KVAT Audit Report. Basically before audit if the notices are received, then the Auditor has to highlight the details if it pertains to the Audit period. For example if the notices are received from the department in the month of September 2014 pertaining to financial year 2010-2011, then the auditor have to highlight the details in the Audit Report.

Entry tax and Professional tax Compliance

There is no clause for the entry tax and professional tax compliance. There is a clause in the Audit report only for the compliance of registration under the respective law. But as an auditor the details can be extracted and can be added to the report if there is no such compliance in the Audit certificate. For example: In case the entry tax has not been paid on notified goods, then the entry tax payable can be highlighted in the KVAT Audit Report.

Books of Accounts Maintained

The auditor has to verify whether the books of Accounts are maintained as specified in the KVAT Rules. For example: Rule 33 of the KVAT Rules specify the maintenance of books of Accounts for the works contractor, Agent, lessee, etc. In case of works contractor the Contractee details register, Receipts details, labour and like charges register, sub contractor register, purchase register, etc

Valuation of stock

There is no specific method specified by the KVAT law for the valuation of the opening stock or closing stock. Basically it differs from dealer to dealer like the valuation may differ for manufacturing industry, Trader, works contractor, etc. In case

of the manufacturing industry the valuation of stock can be different for raw material, semi finished goods and Finished goods, and therefore it has to be separately highlighted in the Audit Report.

Additional place of Business outside the state

In case the dealer has place of business outside the state which is a branch or unit of the place of business within Karnataka, then the details of such additional places should be added to the Report. In case the dealer is partnership firm and one of the partner is engaged in the other firm which is outside the state then as per our view the details of such place of business can be added to the Audit Report. In case the manufactures have various dealers or agents within and outside the state then the details of such agents need not be added to the KVAT Audit Report.

Eligibility of input tax credit as per Special rebate or Partial rebate formula

The KVAT law has specified the formula for the special rebate and partial rebate and if there is discrepancies between the Auditor formula and dealer formula, then the dealer have to highlight in the KVAT Audit report for the eligibility of input tax credit as per his view.

Input tax credit pertaining to interstate sales/Export sales

It is one of the unfeasible clause in the Audit report where it is difficult to ascertain the input tax credit apportioned to interstate sales and Export sales. Basically the dealer deduct the eligible input tax credit from the output tax payable without bifurcating the credit apportioned to local sales and interstate sales as the input tax credit can be adjusted against the local tax as well as CST tax. Therefore in such case the auditor can state that it is not possible to ascertain the input tax credit pertaining to interstate sales as well as export sales.

Sale of Fixed Assets

The Auditor while verifying the books of Accounts of the dealer has to verify the sale of fixed asset and the tax is offered as per the law. In case there is buyback of the fixed asset like motor vehicle, then as per our view it is liable to tax as per the provisions of the law.

TDS certificates (Form 156/158/161)

The Auditor have to verify the TDS certificates as issued by the dealer like TDS certificates to industrial canteen or to the Government contracts.

Composition scheme

The auditor has to specify whether the dealer has opted for composition scheme and have fulfilled the conditions applicable for composition scheme. It was an issue that whether the Auditor have to verify the purchases or not as the composition dealers are not eligible for input tax credit. As per our view the Accounting of purchases with the Invoices have to be verified for the compliances and also it will be helpful if there is a change in the scheme from composition scheme to regular scheme.

SEZ registered dealer

The KVAT Audit Report does not include the details of I form. But as an auditor he has to verify the details of I forms obtained from the department and utilized and should be stated in the Audit certificate in the clause of other information. The Auditor have to verify that the input tax credit/refund is availed as per Rule 130-A.

Operation of the software

In the current scenario, different types of dealers account the transactions in different software and it may be difficult for the Auditor to understand the nature of transactions and accounting of the same. In such scenario he has to take assistance of the dealer to understand the accounting of the transactions and obtain the hard copies for the verification.

Internal Documents by the Auditor

The Auditor should ensure that

- Dealer is registered,
- List the activities undertaken by the business,
- Note the accounting records used by the dealer
- Ensure that records correctly reflect the business activities of the dealer
- Ensure that return and other statutory filings are timely done by dealers.

Reconciliation of contents of Form VAT 240 with the financial statements.

- Gather the information from other Government departments
- If the sales or purchases of the dealer have been fluctuating, should establish the reason
- Trends of the similar business
- Checking of input to output ratio to other business in the same trade to see if they are credible
- Make arithmetical checks on records of sales and purchases until satisfied that they are accurately maintained
- Attempt to reconcile the records on the Vat returns filed with the dealers certified annual accounts
- Link the inputs and capital goods used to the outputs produced by the dealer
- Cross reference system should be used to verify suspicious tax invoices, check on large input tax claims and confirm that sellers are significant.

TRADING ACCOUNT

Stock:

- Reconciliation of the actual stock with financials
- Stock Turnover ratio : Cost of goods sold/Average stock
- Valuation methods of stock like for - Work in progress, Semi finished goods, finished goods,
- Transactions relating to Goods sent for consignment, for approval, for job work, etc.

Turnover- Sales:

- Analysis of Sale price – VAT/CST- freight charges
- Total turnover analysis to different kinds of dealer like works contractor, Principal/agent, hire purchase, leasing, CST sale, composition dealer with accounting standard as applicable.
- Sales turnover with description of goods, rate of tax as applicable

- Transaction analysis of sale whether it is Local, Interstate, export based on documents like high sea sale,
- Classification of sales
- Sale as sample, free gifts, etc
- For works contractor - Sales turnover as declared based on accounting standards like percentage completion method as applicable Vs Time of sale, Rule 3(2) as applicable under KVAT law
- Sales trend for consecutive years
- Gross profit/Sales: ratio
- Sales return/Discount/Tax collection

Turnover- works contract: Expenses: labour charges

- There are number of options under works contract, each with its own restriction/ conditions and benefits.
- Ensuring that the deduction for labour charges is claimed for works contract either on actual basis or on Adhoc basis with the actual charges booked in books of Accounts
- Verification of actual labour charges from direct and indirect expenses claimed depending upon the nature of works contract

Purchases:

- Classification of Purchases- Local, interstate, import
- Classification of registered/Unregistered purchase
- Eligibility of input tax credit with reference to special rebate/partial rebate formula
- Ensuring that input setoff is properly claimed in case of Schedule V items especially on electronic or electrical items
- Booking of any unregistered purchase as expense
- Depreciation on eligible Input tax credit proportion

Purchases/Sales:

- Entry tax on notified goods (from Trading/Balance sheet)
- Interstate purchase of goods for composition dealer to levy local tax
- Eligibility of input tax credit on Capital goods with Fixed Assets register
- Consideration for sale of fixed asset- Fixed Assets register (Balance sheet)/profit or loss of asset
- Sale of car- different rate- subject to conditions
- Rate of tax for packing material
- Analysis of input tax rate with output tax rate as applicable
- Any Special accounting scheme applied by dealer
- Accounting entries – Duties and liabilities- for output and input tax- any excess tax collected forfeited
- Reconciliation of sales and purchases with Company audit report/Income tax audit report
- Excise invoice classification
- Interest cost deduction in case of Hire purchase
- Expenses for administration of office – Extract of URD purchase
- Bank Statements- Advances received – Works contractor/
- Cash sale

Given the nature of business and the volumes involved, the auditor should apply the sampling Audit Techniques for compliance of the KVAT Audit. A combination of provisions and procedures would be an ideal approach to an auditor and the key success factor for an effective audit will be

1. Clear understanding the nature of business of the dealer
2. Verification of the Documents and Controls
3. Effective implementation of the Act and Rules
4. Involving knowledgeable and experienced audit resources.

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Article 366(29-A)(f) and the Constitutional Validity of Service Tax on Air-Conditioned Restaurants and Bars

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On July 3, 2013, a Single Judge of the Kerala High Court declared unconstitutional the levy of service tax on: (1) air-conditioned bars and restaurants; and (2) hotels providing short-term accommodation. The Single Judge found that the levy was beyond the legislative competence of the Union Parliament. The Single Judge, therefore, declared sub clauses (zzzzv) and (zzzzw) of Clause 105 of Section 65 of the Finance Act, 1994, as amended by Finance Act, 2011, as ultra vires the Constitution. The Union of India challenged the Order of the Single Judge in a writ appeal. On October 21, 2014, the Division Bench dismissed the Union's appeal and affirmed the Order of the Single Judge. SeeUnion of India v. Kerala Bar Hotels Association, (W.A. No. 1125/2013 and connected matters). The judgment analyzes some interesting issues pertaining to the 46th Amendment, Article 366(29-A), and the taxing powers of the Union and States. This article analyzes the Kerala High Court judgment insofar as it relates to the levy of service tax on food and drinks supplied in air-conditioned restaurants and bars.

Background.

Even before the Union began taxing services in 1994, the levy of sales tax on the supply of food and beverage had proved to be a highly controversial issue. In State of Himachal Pradesh v. Associated Hotels of India Ltd., (1972) 29 STC 474 (SC), the Supreme Court examined whether sales tax was leviable in respect of meals served to guests who stayed at the hotel. Holding in favour of the assessee, the Court observed that when a hotelier received a guest in his hotel and served him food, the transaction was, essentially, one and indivisible. The Court further held that there was no question of the supply of meals during the stay constituting a separate contract since there was no discernable intention of the parties to sell and purchase food stuff. The Court, therefore, held that the transaction was, essentially, one of service, in the performance of which meals were served as part of, and incidental to that service. Accordingly, the Court held that the Revenue was not allowed to split the transaction and levy sales tax on the sale of food and drink. Broadly, this was the same logic that the Supreme Court had applied in State of Madras v. Gannon Dunkerley, (1958) 9 STC 353 (SC), wherein the Court had held that in a building contract, which is entire and indivisible, there is no sale of goods.

In Northern India Caterers v. Lt. Governor of Delhi, (1978) 42 STC 386 (SC), the Supreme Court held that sales tax cannot be levied on the supply of food and beverage in a restaurant to casual visitors, because the transaction is in the nature of a service. The Supreme Court, therefore, held that the Revenue was not entitled to split up the transaction into two parts -- one for sale of goods and the other for service. In other words, the Supreme Court held that the activity of supplying food and drink in a restaurant was indivisible in nature, and that the dominant intention was the rendering of services. Accordingly, the Court held that States were not competent to bifurcate the transaction and levy sales tax on the aspect relating to the sale of goods. Subsequently, in a review petition filed by the Revenue, the Court clarified that, where food was supplied in a restaurant, and it was factually established that the dominant object was the supply of food and the rendering of service was merely incidental, the transaction would be exigible to sales tax.

In order to overcome the effect of the Apex Court's decision in Northern India Caterers, the 46th Amendment to the Constitution inserted Article 366(29-A)(f). Under Article 366(29-A)(f), "tax on the sale of purchase of goods" was deemed to include, "a tax on the supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or any drink (whether or not intoxicating), where such supply or service, is for cash, deferred payment or other valuable consideration." Therefore, by amending the Constitution, Parliament permitted the States to do what the Supreme Court had held was impermissible in Northern India Caterers' case – tax the value of food and beverages that are supplied by way or as part of any service.

Pursuant to the 46th Amendment, the State Legislatures amended their respective sales tax legislations in order to levy tax on the supply of food and drink by way or , or as a part of any service. Thereafter, in K. Damodarswamy Naidu v. State of Tamil Nadu, (2000) 117 STC 1 (SC), the assessee contended that, even after the 46th Amendment, sales tax could be levied on only the price of food and drink that was supplied and that the value of services rendered while supplying the food and drink was deductible. More specifically, the assessee contended that sales tax on food served in restaurants could not be levied on the sum total of the price charged to the customer, and that the charges paid by the customer had to be split up into what was charged for the service and what was charged for the food and drink. Rejecting the contentions of

the assessee, a Constitution Bench of the Supreme Court held that Article 366(29-A)(f) "permits the States to impose a tax on the supply of food and drink," (emphasis in original) and that, therefore, tax was leviable on the "supply" of food and beverages, which included the element of service rendered in order to supply the food and drink. The Court, therefore, held that "the price that the customer pays for the supply of food in a restaurant cannot be split up," as suggested by the assessee. Therefore, according to the Court, sales tax was leviable on the total amount charged in a restaurant for the supply of food and drink, including the amounts charged for services that are rendered.

After the Supreme Court's judgment in K. Damodarswamy Naidu, the position of law was fairly clear: States were competent to levy sales tax on the total amount of charges collected for supply of food and drink in a restaurant.

Thereafter, in 2011, Parliament sought to levy tax on services provided by high-end restaurants that were air-conditioned and served liquor. Accordingly, Section 65(105)(zzzzv) was inserted into the Finance Act, 1994, and the relevant taxable service was defined as under:

> Section 65(105)(zzzzv). *"Taxable service means any service provided or to be provided, to any person, by a restaurant, by whatever name called, having the facility of air-conditioning in any part of the establishment, at any time during the financial year, which has license to serve alcoholic beverages, in relation to serving of food or beverage, including alcoholic beverages or both, in its premises[.]"*

Pertinently, the levy of tax was restricted to the service element in the activity of supply of food and beverages. Since, in most cases, it was not possible to bifurcate the amount charged for the supply of food and beverages, and the amount charged for the service provided, Rule 2C of the Service Tax (Determination of Value) Rules, 2006, stated that tax would be leviable on 40% of the total charges. In short, 40% of the total amount billed for supply of food and drink in a restaurant was deemed to be towards services rendered and, accordingly, 60% of the total charges was provided as a deduction.

The constitutional validity of the levy of service tax was challenged by a number of restaurant owners before the High Courts of Bombay and Kerala. The primary contention of the Petitioners was that, after the insertion of Article 366(29-A)(f), the power to tax the supply of food and drink in restaurants was reserved for the States under Article 246 read with Entry 54 of List II of the VII Schedule to the Constitution. In essence, the restaurant-owners contended that by levying service tax on the transactions provided under sub-clause (zzzzv) of Section 65(105), the Union was encroaching on the power reserved for the States under Entry 54 of the State List.

On July 3, 2013, a Single Judge of the Kerala High Court accepted the Petitioners' contentions, allowed the writ petitions, and struck down Section 65(105)(zzzzv) as being ultra vires the power reserved for Parliament under the Constitution.

On April 8, 2014, a Division Bench of the Bombay High Court, disagreeing with the view taken by the Kerala High Court, upheld the validity of the impugned provision, thereby sustaining the levy of service tax on the supply of food and drink in air-conditioned restaurants and bars. SeeIndian Hotels and Restaurant Association v. Union of India, (WP No. 2159/2011). In short, the Bombay High Court held that the Constitution does not prohibit Parliament from levying service tax on the supply of food and drink in a restaurant and that, accordingly, Parliament is competent to impose the tax in question.

In a writ appeal filed by the Union challenging the order of the Single Judge of the Kerala High Court, the Petitioners argued that, after the 46th Amendment to the Constitution and the insertion of Article 366(29-A), the supply of foods and beverages by way or as part of any service is deemed to be a sale of goods. The Petitioners contended that Parliament, in exercise of its residuary power under Entry 97 of List I, does not have the power to levy service tax on a transaction that is deemed by the Constitution to be a sale of goods.

After noting the contentions of the parties, the Court traced the history of the 46th Amendment and observed that the supply of food and beverage was deemed to be a sale of goods under the provisions of Article 366(29-A)(f). In this regard, the High Court relied extensively on the judgment of the Supreme Court in K. Damodarswamy Naidu, and concluded that Parliament does not have the power to tax the service aspect involved in the supply of food and drink. The Court observed that, after the insertion of Article 366(29-A)(f), the power to tax the entire transaction relating to the supply of food and drink is reserved for the States. Accordingly, the Court held that the levy of service tax pursuant to the residuary power reserved for the Union encroaches on the taxing power of the States. The Court, therefore, struck down the provisions of Section 65(105)(zzzzv) as being unconstitutional.

Analysis.

In order to better understand the issue, it would be pertinent to note certain observations of the Supreme Court in the case of Tamil Nadu KalyanaMantapam v. Union of India, AIR 2004 SC 3757. In the said case, one of the contentions raised by the assessees was that the levy of service tax on catering services provided by mandap-keepers is outside the legislative competence of Parliament as the said transaction is deemed to be a sale of goods as per Article 366(29-A)(f). More specifically, the assessees argued that, in view of the definition of "tax on the sale or purchase of goods" provided under Article 366(29-A)(f), catering services provided were deemed to be a sale of goods and, therefore, only the States

were competent to levy tax on the said transactions. The Supreme Court rejected this argument, holding that Article 366(29-A)(f) "only permits the State to impose a tax on the supply of food and drink by whatever mode it may be made." The Court further observed that, "it does not conceptually or otherwise include the supply of services within the definition of sale and purchase of goods."

The Court further reasoned that, "this is particularly apparent from the following phrase contained in the said sub-article: 'such transfer, delivery or supply of any goods shall be deemed to be a sale of goods.'" In this regard, the Court explained that, "the operative words of the sub-Article is supply of goods and it is only supply of food and drinks and other articles for human consumption that is deemed to be a sale or purchase of goods." Accordingly, the Court concluded by observing as under:

> *"The concept of catering admittedly includes the concept of rendering service. The fact that tax on the sale of goods involved in the said service can be levied does not mean that service tax cannot be levied on the service aspect of catering."*(Emphasis supplied).

Following the above ratio of the Supreme Court's judgment, the Bombay High Court, in Indian Hotels and Restaurant Association, held as under:

> *"The Honourable Supreme Court, with respect, held that the concept of catering admittedly includes a concept of rendering service. The fact that the tax on sale of goods involved in the said service can be levied, does not mean that service tax cannot be levied on the service aspect of catering. With respect, this means that when a restaurant renders to any person a service, the tax on sale of goods involved in the said service can be levied. That does not mean that service tax cannot be levied on the act of serving food at a restaurant."* (Emphasis supplied).

The Supreme Court's classic decision in Bharat Sanchar Nigam Ltd. v. Union of India, (2006) 145 STC 91, throws further light on this issue, albeit in obiter. While discussing the true purport of the insertion of Article 366(29-A), the Court observed that the 46th Amendment permitted specific composite contracts, that is, works contracts, hire-purchase contracts, and catering contracts "to be divisible contracts where the sale element could be isolated and be subjected to sales tax." Applying the Supreme Court's observations, it can be seen that all Article 366(29-A)(f) provides for is: (1) the splitting up of a composite catering contract which involves an element of sale and service, and (2) the levy of tax by the States on the sale element. It was precisely this aspect that the Supreme Court analyzed in Tamil Nadu KalyanaMantapam's case, and held that Article 366(29-A)(f) does not, expressly or implicitly, bar the levy of tax by the Union on the service element.

As stated earlier, in K. Damodarswamy, it was held that sales tax is leviable on the entire consideration paid for the supply of food and drink in a restaurant, and that the service portion cannot be split up and deducted. More specifically, the Constitution Bench had held that Article 366(29-A)(f) permits States to tax the supply of food and drink, which includes the activity of service. K. Damodarswamy, therefore, appears to be an outlier as regards the interpretation of Article 366(29-A)(f). All the other judgments of the Supreme Court have interpreted the provision to mean that it allows for the levy of sales tax on only the sale element. In other words, other than in K. Damodarswamy, the Supreme Court has consistently held that Article 366(29-A)(f) permits the States to split an otherwise indivisible contract and tax the sale of goods involved in the transaction. However, it is critical to note that K. Damodarswamy was rendered by a Constitution Bench and, therefore, cannot be said to be overruled by subsequent judgments of the Court.

Let us now shift our attention to the decision of the Kerala High Court, where the assessees' primary contention was that, after the insertion of Article 366(29-A)(f), the activity of supplying food and drink was deemed to be a sale of goods and that, therefore, the service aspect of the transaction could not be taxed under the Finance Act, 1994. In essence, the contention raised before the Kerala High Court was identical to that raised before the Supreme Court in Tamil Nadu KalyanaMantapam. The Kerala High Court, however, distinguished the Supreme Court's judgment in Tamil Nadu KalyanaMantapam by stating that "the supply of food and other consumables in a restaurant cannot be equated with the services rendered by a mandap keeper in relation to the use of mandaps and also the services, if any, rendered by him as a caterer." Instead, the Kerala High Court relied extensively on the judgment of the Supreme Court in K. Damodarswamy, and held that the entire transaction, including the service portion, is deemed to be a sale of goods and, therefore, not exigible to service tax.

With great respect, the author is of the opinion that the judgment of the Kerala High Court does not lay down the right law. On the contrary, the judgment of the Bombay High Court in Indian Hotels and Restaurant Association appears to be correct. Needless to state, the law of precedents requires Courts to follow K. Damodarswamy and not Tamil Nadu KalyanaMantapam, as the former was rendered by a larger bench. However, the Bombay High Court has succinctly explained why the decision in K. Damodarswamy is not applicable to the issue of whether service tax is leviable. The relevant observations of the court are as under:

> *"It is, therefore, clear that a sales tax is on the sale of goods. While selling, supply thereof is contemplated and covered by Article 366(29-A)(f) of the Constitution of India. It does not mean that the service during the course of or while supplying the goods is taxed, but the tax is and remains on the sale of goods. That is why the State Legislatures were held to be empowered to impose, levy, assess and recover a tax on sale of articles of food*

and drink which have been termed as 'goods'. Once the observations of the Honourable Supreme Court and the Constitutional definition is understood in this context, then, we do not feel that any assistance can be derived by the Petitioners from the judgment in K. Damodarswamy Naidu (supra). The judgment of the Honourable Supreme Court in no way decides the controversy before us far from holding that the Parliament is incompetent to impose and levy a tax on services provided in air-conditioned restaurants." (Emphasis supplied).

In my opinion, the Kerala High Court ought to have, like the Bombay High Court did, followed the judgment in Tamil Nadu KalyanaMantapam and upheld the levy, rather than following K. Damodarswamy, where the issue of levying service tax was never examined.

Conclusion.

In sum, the Division Bench of the Kerala High Court appears to have erred in striking down the levy of service tax on air-conditioned bars and restaurants, as provided for under Section 65(105)(zzzzv). In my opinion, the decision of the Bombay High Court in Indian Hotels and Restaurant Association, relying on Tamil Nadu KalyanaMantapam, lays down the correct law, although it is arguable that some of the observations in Tamil Nadu KalyanaMantapam, which is a Division Bench judgment of the Apex Court, run counter to the Constitution Bench judgment in K. Damodarswamy, particularly with regard to the interpretation of Article 366(29-A)(f). However, as explained by the Bombay High Court, K. Damodarswamy has no precedential value as regards the question of levying service tax. Therefore, in my opinion, the Bombay High Court has rightly applied the judgment in Tamil Nadu KalyanaMantapam and not K. Damodarswamy.

However, one issue that was not specifically dealt with by either High Court relates to one of the most vexed issues in recent times -- the dual levy of service tax and sales tax on the same turnover. As explained earlier, in K. Damodarswamy Naidu, the Supreme Court has held that sales tax is leviable on the total price that a customer pays for the supply of food and drink in a restaurant, and that an assessee cannot split up the contract and pay sales tax on only the sale element involved. It is pertinent to note that K. Damodarswamy is still good law and, consequently, what is certain is that, insofar as the levy of sales tax is concerned, the entire consideration collected for the supply of food and drink, including charges for services rendered, is exigible to tax.

On the other hand, service tax is now leviable on the service element of the transaction. The law provides that if it is not possible to show the actual amount received towards services rendered, 60% is deemed to be collected for supply of food and drink, and service tax is leviable on the balance 40%. Therefore, on 40% of the price, both sales tax and service tax is leviable. The argument relating to the dual levy of sales and service tax was not raised before the Constitution Bench in K. Damodarswamy and, therefore, the Court did not have an occasion to examine it.

More recently, a number of judgments of the Supreme Court and High Courts across the country have held that sales tax and service tax are mutually exclusive, and that both taxes cannot be levied on the same turnover. The dual levy on air-conditioned bars and restaurants is just another in a long line of cases where the Central and State Governments are subjecting the same turnover to service tax and sales tax, respectively. As always, it is the end-consumer who eventually suffers from this dual levy. Hopefully, the Supreme Court will soon resolve this and other issues that arise in this interesting case.

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KSCAA WELCOMES NEW MEMBERS - DECEMBER 2014

	Name	*Place*
1	Narayana Murthy K.	Bengaluru
2	Prashant Hegde	Bengaluru
3	Jagadeesh Narayana Bhat	Bengaluru

One More Opportunity - Service Tax Audit

CA. Madhukar N. Hiregange and **CA. Roopa Nayak**

In this article we look at the implications of recent notification which has **empowered service tax audit by Chartered Accountant in addition to revenue officers.** *There have been a lot of disputes with quashing of Rule on audit [5A(2)], leading to questioning of legality of service tax audit. This notification is in response to the recent judicial decisions. This could also be a defense for writs lying before the various High Courts.*

Background

The conduct of an audit today maybe the ONLY check against the tax payer taking the payment of tax lightly. The philosophy is that the Government trsuts the tax payer but wishes to ensure compliance and payment of just dues. Earlier all tax yaers were scrutinized. The reduction in the number of assesses picked up for audit makes the need for audit imperative.

Circular No. 986/ 10/ 2014-CX clarifyied that the excise audit can be done by Central Excise officers. There has been notification 23/2014-ST that chartered accountants and Cost accountants's can conduct service tax audit. We would recall the provisions enabling service tax audit and its legality in this regards before examining implication of latest change.

Whether service tax audit is legal?

The rule making power under service tax is conferred upon executive in Section 94 of the Finance Act. In the past the only provision in Chapter V of the Finance Act on scrutiny and audit of records of the assessee is Section 72A of the Finance Act, 1994.

A special audit could be undertaken if the circumstances outlined in Section 72A are fulfilled. The fact that Section 72A prescribes the conditions meriting such special audit leads to the inference that there was no intend to provide for a general audit that "every assessee" may be subjected to, "on demand".

Section 72A empowers an audit of an assessee's records only in special circumstances, namely, when there is a failure to declare or compute the value of the taxable service, when the utilization of CENVAT credit in excessive of the limit permissible or by fraud etc., or when the business operations of the assessee are dispersed across multiple locations.

At the same time, as per Rule 5A(2) of Service Tax Rules, 1994 every assessee was required to make available on demand specified documents to the authorized officer or audit party deputed by the Commissioner or C&AG within 15 days from date of demand or such extended period allowed.

In ACL Education Centre Private Limited v. UOI - 2014-TIOL-120-HC-ALL-ST, the Allahabad High Court held that Rule 5A(2) only empowers the officers, as duly authorized by the Commissioner to ask for and collect records from the assessee. The audit can only be undertaken by an authorized Chartered Accountant or Cost Accountant, as provided in Section 72A. The High Court also made an observation that in case of Government Autonomous Body, the function of the audit has been assigned to the Comptroller & Auditor General of India.

The Calcutta High Court in SKP Securities Limited v. Deputy Director - 2013-TIOL-38-HC-KOL-ST. In this case, the High Court held that no provision in Chapter V of the Finance Act, 1994 or the CAG Act, 1971 empowers the CAG to undertake audit of accounts of a non-governmental assessee as these assessees are not in the receipt of any aid or grant from the government.

In terms of HC decision in Travelite (India) Vs. UOI &Ors. 2014-TIOL-1304-HC-DEL-ST on the Service Tax Audit issue it is held that: Rule 5A(2) of the Service tax Rules is ultra vires the provisions of the Finance Act and the rule has been struck down.The Court had held the opinion that any attempt to include provision for such a general audit through the back-door, such as through the impugned rule, is ultra-vires the rule making power conferred under Section 94(1). Rule 5A(2) must consequently be struck down.

The decision of the Delhi High Court was based on the principle that the Rules are merely to give effect to the Statute's provisions and intent and the same cannot go beyond the four corners of the Statute.

Since the parent statute in this regard, the Finance Act, 1994 itself does not authorise a general audit of the type envisioned by the Rule 5A(2). There was no other substantive provision which justified a probe into the records of the assessee, under conditions akin to those contemplated by Rule 5A(2). As the Finance Act which is the parent statute under service tax does not authorize a general audit of type covered in Rule 5A(2) of ST Rules.

The CBEC circular no.137/26/2007-CX 4 which sought to put in place a mechanism for department of audit and scrutiny of documents, was not only an attempt to widen the scope of the law impermissibly but also contrary to the statute. The said circular, to the extent it provides clarifications on a Rule 5A(2) audit, was also quashed by the Delhi High Court in the Travelite decision 2014-TIOL-1304-HC-DEL-ST.

The decision in Travelite mentioned at supra also struck down circular no. 137/26/2007-CX.4 dated 1.1.2008 regarding to audit by department for reason that executive instructions without statutory force cannot possibly override law. Consequently any

notice, circular, guideline etc contrary to statutory laws cannot be enforced.

Changes consequent to the Court rulings

Chapter V of the Finance Act, 1994 deals with the matter relating to levy and collection of service taxes on various taxable services and for this purpose Service Tax Rules, 1994 have been framed. Section 94 of the Finance Act enables the Central Government to make rules for carrying out the provisions of Chapter V of the Finance Act.

It is pertinent to note that the FA (No.2)Act, 2014 amended the provisions of rule-making powers under Section 94(2) to insert(k) as follows:

(1) The Central Government may, by notification in the Official Gazette, make rules for carrying out the provisions of this Chapter.

(2) In particular, and without prejudice to the generality of the foregoing power, such rules may provide for all or any of the following matters, namely(a) ……

The substituted provision now reads as under:

(J) in section 94, in sub-section (2), for clause (k), the following clauses shall be substituted, namely:-

"(k) imposition, on persons liable to pay service tax,for the proper levy and collection of the tax, of duty of furnishing information, keeping records and the manner in which such records shall be verified,'……

It may be noted that the term"manner in which such records shall be verified" used in the section could be said to include audit by the Departmental officers, under Rule 5A(2)? It can be inferred that now there is a duty on person liable to service tax of providing information, keeping records and manner in which such records kept be verified.

Though it fixes a responsibility on the tax payer in relation to his obligation for furnishing of information, keeping records and the manner in which the records shall be verified. It does not specify who the records shall be verified by, and circumstances in which such verification is to be done. Already audit intimation letters are being issued to assesses by department officers citing legality of service tax audit in view of the substituted sub-clause in Section 94.

Scope and impact of the recent notification

As per latest notification 23/2014-ST sets out as under:

…….In the Service Tax Rules, 1994, in rule 5A, for sub-rule (2), the following sub-rule shall be substituted, namely:-

"(2) Every assessee, shall, on demand make available to the officer empowered under sub-rule (1) or the audit party deputed by the Commissioner or the Comptroller and Auditor General of India, ***or a cost accountant or chartered accountant*** *nominated under section 72A of the Finance Act, 1994,-*

(i) the records maintained or prepared by him in terms of sub-rule (2) of rule 5;

(ii) the cost audit reports, if any, under section 148 of the Companies Act, 2013 (18 of 2013); and

(iii) the income-tax audit report, if any, under section 44AB of the Income-tax Act, 1961 (43 of 1961), for the scrutiny of the officer or the audit party, or the cost accountant or chartered accountant, within the time limit specified by the said officer or the audit party or the cost accountant or chartered accountant, as the case may be."

From above can infer assessee on demand shall provide to the officer authorised by Principal Commissioner or Commissioner[said officers] or the audit party deputed by the Commissioner or the Comptroller and Auditor General of India, or a cost accountant or chartered accountant nominated under section 72A of the Finance Act, 1994 specified documents for the scrutiny of the officer or the audit party, or the cost accountant or chartered accountant, within the time specified by the said officer or the audit party or the cost accountant or chartered accountant.

This notification seems to give effect to the direction in ACL Education mentioned at supra, "During the course of arguments, learned Additional Solicitor General of India has assured that the audit will be performed by a qualified Chartered Accountant and as per accounting standard".Ultimately, the audit will be conducted by the Audit Party headed by the Chartered Accountant/Cost Accountant, as the case may be, deputed by the Commissioner. Here the important aspect maybe to ensure the independence and integrity of the auditor who does the service tax audit.

The Institute of Chartered Accountants of India had introduced a certificate course on Indirect Taxes wherein a 12 days workshop oriented course was put in place in 2011. The approximate number of professionals who have undergone this and passed the examination thereafter maybe in excess of 1200. Also a 3 or 4 day course on understanding service tax had more than 15000 CAs completing that knowledge updation training. These professionals could be preferred to ensure that the quality of the audits are high.

Alternatively a test to qualify could be prescribed for the professionals to be enabled to conduct sch audits. This could be carried out like the professional examinations by the respective Institutes.

Conclusion

As of date there is no clarity as to the powers of conducting audit of private parties under service tax law.Notwithstanding the legality of audit, sufficient checks and balances to be put in place to ensure that the mandate to the CA/CMA to undertake audit is done by competent persons with requisite knowledge of service tax provisions. This is also a landmark opportunity for professionals to be able to contribute to the country and uphold the high ethical standards of the profession.

In this article the paper writers have sought to examine the legality of service tax audit in light of recent notification.

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Issue of Shares and Transfer Pricing - Vodafone Bombay High Court Ruling

CA. Krishna Upadhya S

Transfer Pricing Controversy

Transfer pricing has been a major area of litigation in the Indian taxation scenario. The taxpayers and tax authorities are getting equally aggressive in managing and probing transfer pricing matters in India. It is also said that India has the largest number of transfer pricing cases in the world. In some surveys that were conducted amongst CFOs of top multi nationals in India recently, transfer pricing has emerged as their major area of concern and also been an area with maximum amount of unresolved disputes.

Tax authorities are constantly aiming at increasing their tax base and they are invariably believing that the multinationals are making undue profits and using the transfer pricing as a tool to possibly curtail the same. This has resulted in actions by tax authorities which are not justunconventional but also against the set principles of taxation in India.

One such unconventional approach was made by tax authorities to tax the shortfall in premium collected on issue of shares by Vodafone Tele Services (India) Holding Ltd's case[1].

Facts of the case

Vodafone India Services Pvt. Ltd (Vodafone India) is a wholly owned subsidiary of a nonresident company, Vodafone Tele-Services (India) Holdings Limited (the holding company). It issued 2,89,224 equity shares of Rs. 10 each at a premium of Rs. 8,509, i.e. each share at Rs. 8,519 to its holding company, raising an amount of Rs.246.38 crores. This value was computed in accordance with the methodology prescribed by the Government of India under the Capital Issues (Control) Act, 1947.

With abundant caution, Vodafone in its Form 3CEB filed for AY 2009-10 had reported the above transaction with a note that 'this transaction has been reported by way of abundant caution, despite the fact that the transaction of issue of equity shares did not affect the income of the Company as required u/s 92(1) of the Income Tax Act, 1961 (Act) for applicability of TP provisions'.

The Company's case was picked up for scrutiny assessment u/s 143(2) of the Act and as the threshold limit for international transaction was more than Rs.15 crore, AO made a reference of all the transactions to the Transfer Pricing Officer (TPO) for computation of Arms Length price (ALP).

The TPO passed his order re-computing the ALP of issue of equity shares. While doing so, the TPO used the Net Asset Value (NAV) method for computing the ALP and came to a total valuation of Rs.53,775 per share. Further TPO held that since the value at which the share were issued were Rs.8,519 a shortfall of Rs. 45,256 arises, which ultimately results in a total shortfall of Rs.1308.91 crores. He further went on to hold that this shortfall was a deemed loan extended by Vodafone India to its holding company and an interest at 13.50% was chargeable which would amount to Rs.88.35 crores. In total, making a TP adjustment of Rs. 1,397.26 crores.Based on the above, the AO passed a draft order u/s 143 r.w.s 144C of the Act.

Vodafone India contested this simultaneously at two different forums. Firstly, it raised the issue of computation before the Dispute Resolution Panel (DRP) and questioned the jurisdiction of the TPO to pass an order under Chapter X of the Act (TP provisions) on issue of shares before the Hon'ble Bombay High Court through a writ petition.

The Hon'ble Bombay High Court remanded the matter back to the DRP to decide on the question of jurisdiction of TPO to invoke TP provisions in transaction involving issue of share. The DRP upheld the order of TPO and held that the premium to the extent not received, is an income arising from issue of shares. Against this order Vodafone India filed another writ petition before the Hon'ble Bombay High Court.

Arguments before the High Court

Vodafone India argued that Chapter X of ITL are special provision relating to avoidance of taxes and provide for computation of income from international transactions of AEs with respect to Arms Length Price. While issuing share to its holding company Vodafone India has not earned any income and the question of taxing the same will not arise and Chapter X is not designed to bring to tax sums which are otherwise not taxable. Moreover, while interpreting the law the law cannot be expanded to give purposeful interpretation. It has also said that issue of shares is not transfer of shares but a creation of property as the shares are being issued for the first time. Vodafone India also argued that Capital receipts cannot be brought to taxunless specifically/ expressly brought to tax by the Act.

Attention was also brought to section 56(2)(viib) which seeks to tax consideration received for issue of shares in excess of FMV to a resident and not the short fall in consideration received.

[1] Vodafone India Services (p.) Ltd vs UOI [2014] 50 taxmann.com 300 (Bombay)

On the contrary, the Tax authorities contended Indian TP Regulations are a code in itself and not merely a machinery provision to compute Arms Length Price of a transaction. Income as defined in Section 2(24) is an inclusive definition and should not be viewed in a narrow sense. In this case, by issuing shares at a lower price Vodafone India has extinguished/ relinquished its right to receive FMV of the shares and therefore issue of shares is a transfer as defined in Section 2(47) of ITL. The tax authorities also argued that what is being brought into tax is not share premium but is the cost incurred by the Petitioner in passing on a benefit to its holding company by issue of shares at a premium less than ALP. This benefit is the difference between the ALP and the premium at which the shares were issued.

Ruling of the Bombay High Court

After considering both the arguments and thoroughly reiterating the TP provisions, the Hon'ble Bombay High Courtby relying on the Apex court decision in CIT v. D.P. Sandu Bros. Chember (P) Ltd. 273 ITR 1, which has upheld the decision of Bombay high court ruling in Cadell Weaving Mill Co. v. CIT 249 ITR 265 held that 'in this case what is being sought to be taxed is capital not received from a non-resident. Therefore, absent express legislation, no amount received, accrued or arising on capital account transaction can be subjected to tax as Income',

On the contention of the revenue that the definition of International Taxation in the sub clause (c) and (e) of Explanation (i) to Section 92B of the Act should be given a broader meaning to include notional income, the High Court held while interpreting a fiscal/taxing statute, the intent or purpose is irrelevant and the words of the taxing statute have to be interpreted strictly. The court gave reference to MathuramAgarwal v. State of M.P. 1999 (8) SCC 667where the Supreme Court held that in a taxing Act it is not possible to assume any intention or governing purpose of the statute more than what is stated in the plain language. It is not the economic results sought to be obtained by making the provision which is relevant in interpreting a fiscal statute.

The court observed that ***(a)subject of tax, (b) person liable to pay tax, (c) rate at which the tax is to be paid, and (d) measure or rate at which the rate is to be applied*** are the four essential ingredients to a taxing statute. Arriving at the transactional value/ consideration on the basis of ALP does not convert non-income into income. The tax can be charged only on income and in the absence of any income arising, the issue of applying the measure of ALP to transactional value/ consideration itself does not arise. The issue of shares at a premium is a capital account transaction and not income. The High court also observed that 'it is well settled position in law that a charge to tax must be found specifically mentioned in the Act. In the absence of there being a charging Section in Chapter X of the Act, it is not possible to read a charging provision into Chapter X of the Act. Chapter X of the Act is a machinery provision to arrive at the ALP of a transaction between AEs. The substantive charging provisions are found in Sections 4, 5, 15 (Salaries), 22 (Income from house property), 28 (Profits and gains of business), 45 (Capital gain) and 56 (Income from other Sources).'

The High court also invoked a very important principle that, there is a qualitative difference between the charging and computation provisions. In the present case, it held that there is a computational provision but no charging provision to tax issue of share and held that these facts are on a higher pedestal as compared to the ruling in the case of CIT v. B. C. SrinivasaShetti 128 ITR 294 of the Apex court, where there was charging section and no computation provision.

Considering all these the High court held that "*in the present facts issue of shares at a premium by the Petitioner to its non resident holding company does not give rise to any income from an admitted International Transaction. Thus, no occasion to apply Chapter X of the Act can arise in such a case.*"

Conclusions and Implications

Uncertain tax regimes and infamous retrospective amendments had lower the investor confidence in India economy and the investors are looking at investing in India as being risky. Further, the 'Doing business in India' report by the World Bank in its ease of doing business segment has lowered India's ranking to 142 out of 189 countries. These circumstances coupled with such creative interpretations of tax laws by the tax authorities in the name of safeguarding the revenue looks extremely discouraging. It is nobody's argument that the multinationals needs to be allowed to carry out aggressive tax avoidance measures and plan their structures in a way that would result in erosion of tax base for a country.However at the same the tax administration should also exercise necessary restraint while arriving at such fancy and astronomical assessment orders, which could have repulsive effects on the economy as a whole.

Kautilya, in his Arthashatra written close to 2,400 years back mentions that '*a ruler should not tax at his pleasure*'. He also mentions that a '*ruler should exercise all measures to collect taxes from his subjects but also mentions that the approach should be lenient and he should adopt caution while deciding the tax structures*'. It looks as if the tax administration in India has only understood the former part of his advocacy and conveniently ignored the latter part of it.

The above ruling of the High court comes in the backdrop of the Government's initiatives for encouraging foreign investments and may play a very significant role in such an effort. Further, we also understand that there are number of other companies involved in similar TP litigations and this case should definitely influence all of them constructively.

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International Tour

Organized by **Bangalore Branch of SIRC of ICAI**
Jointly with
All other Branches of SIRC of ICAI of Karnataka and
Karnataka State Chartered Accountants Association (R)

INDONESIA – BALI – MALAYSIA 6 Days / 5 Nights

from 3rd to 9th February 2015

TENTATIVE DATE OF JOURNEY:

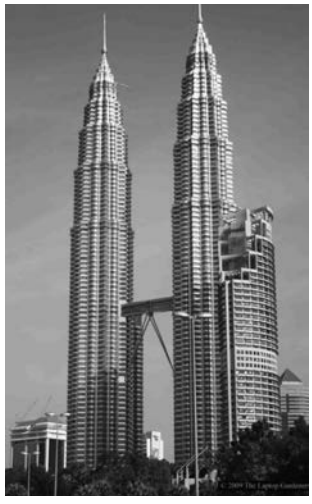
03-02-2015 to 08-02-2015 or
04-02-2015 to 09-02-2015
depend upon the availability of seats as the number of passangers travelling together is more.

Total Tour Cost – Rs.56, 000/- (All Inclusive)
per person (6 Days/5 Nights)
a. Child no bed – 75% of tour cost (5-12 years)
b. Child no bed – 65% of tour cost (2-5 years)
c. Single room supplement – Rs.15,000 extra

Mode of Payment: *Cheque /DD in favour of* ***"Bangalore Branch of SIRC of ICAI"*** *payable at Bangalore.*
For online Registration visit: **www.bangaloreicai.org**

VISA REQUIREMENTS:

1. Passport in original having validity of a minimum of 6 months prior to the date of travelling
2. Colour photos 3.5cmX4.5cm with white background, full face & matt finishing, 4 No.s of each passengers



TOUR COST INCLUSIONS:

1. Return Economy Airfare from Bangalore
2. All Airport Taxes
3. Visa charges of Indonesia (single entry) & Malaysia (multiple entry valid for 12 months)
4. All transfers by good vehicle
5. English speaking guide
6. 3 Star Hotel stay on twin share basis
7. Buffet Breakfast at hotel coffee shop
8. Fixed menu of Lunch & Dinner at Indian Restaurant
9. Daily 2 Half liter bottles of Mineral water
10. Sightseeing in Bali - Uluwatu Temple, Magical Show of Kecak and Fire Dance, Batubulan village, Tegenunga Waterfall, Batur Volcano, Ubud Palace, Taman Ayun Royal temple, Gobleg Hill, Alas Kedaton monkey forest, Tanah lot sea temple.
11. Sightseeing in Malaysia – Batu Caves, KL Tower, Petronas Twin Tower, Genting Highland and Putrajaya Tour

TOUR COST EXCLUSIONS:

1. Telephone charges, Pay TV, Tips to Driver & Guide, Mini Bar, Laundry, after meals any kind of beverages and any others not mentioned in the above itinerary. Service Tax 3.09% extra

Last Date for confirmation of Booking : 25th December 2014

Detailed itinerary of the International Tour with hotel details will be shared through e-mail.

For more details contact :
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M/s. Jamkhandi Sugars Limited.

At: Hirepadasalagi, Post: Naganur - 587 301, Tq: Jamkhandi Dt: Bagalkot, Karnataka (INDIA)
Phone: 08353-254161/62/63/64 | Fax: 08353-254160 | Email: info@jamkhandisugars.com

Manufacturing facility at Hirepadasalagi, Jamkhandi Taluk, Bagalkot District

Shri S. B. Nyamagouda (MLA)
Chairman

M/s Jamkhandi Sugars Limited is "First Farmers Public Limited Company in the Nation". We started this company with 2500 TCD and 12.3 MW Co-generation in the year 2001. Now we are pleased to inform that, we have now expanded the capacity from 2500 TCD plant to 6500 TCD and additional 17.5 MW co-generation. We are setting up a new Distillery plant of 60 KLPD capacities.

VISION AND MISSION

- JSL Stands with the collective efforts and confidence of our farmers, workers, vendors and mainly our valued share holders have helped us in growing ever during the industry down turn. We have given special consideration to our share holder, farmers and to our social obligations. JSL is geared up to think beyond the crystal.
- To provide energy to the energy starred nation by making best use of its bi-product called Bagasse which is converted to power and another bi-product called Molasses which is translated to ethanol. To maximize and make best use of Agri industry in India and helping the farmers of the nation who happen to be the backbone of the nation.
- To increase the value of share holders investments with a continuous improvement in financial performance and by adding value to our bi-products.
- JSL would like to bring down cost of conversion by adopting economies of scale strategy then company expands its capacity of sugar production, cogeneration and ethanol by adding additional equipments to the existing unit and also setting up another unit of 3500 TCD with 30MW cogen.
- JSL plans to grow with the farmers of the region. Company intends to grow and let the farmers of the region grow along with the Company.

AWARDS:

- JSL received Silver Award for the "Best Cane Development" for the season 2013-14 from SISTA, Vishakhapattanam.
- JSL received 2nd Prize for "Best Co-generation Award (2012-13)" for Karnataka Region, SISTA, Chennai
- JSL has established new Sugar Factory at Nad KD village, Indi taluk with a crushing capacity of 3500 tonnes and 27 MW of power generation.
- JSL received 3rd Prize award for "Best Sugarcane Development Award (2009-10)" for Karnataka Region"
- Received award for "BEST PERFORMANCE SUGAR FACTORY SECOND PLACE FOR BEST CO-GENERATION AWARD (2007-08)" from SISSTA.
- Received award for "BEST PERFOAMCE SUGAR FACTORY" from SISSTA on 38th SISSTA Annual Convention held in Chennai on 9th August 2007.
- Received award for "BEST PERFORMANCE SUGAR FACTORY AND BEST CANE DEVELOPMENT" Second Place in Karnataka for the Crushing Season 2006-07 from SISSTA.

Manufacturing facility at Indi Taluk, Vijayapura (Bijapur) District

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