KSCAA

Karnataka State Chartered Accountants Association ®

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GST | KVAT Audit | Indirect Taxes | Foreign Tax Credit Rules | Financial Reporting | Establishing Foreign Entities

BASAVANAGUDI CPE STUDY CIRCLE

Discussion on

Demonetization & Black Money

on Friday, 23rd December 2016

Karnataka State
Chartered Accountants Association®

Interactive Session on

Migration of
Existing Tax Payers under GST

on Monday, 2nd January 2017

Details Inside ▸

Celebrating 60 *years*

1957-2016

Wishing you all
a Happy New Year 2017 & Makara Sankranti

From the President

Jnanam Sa-Vijnanam
Creating Knowledge Consciousness

Dear Members,

It is often said: "If we have no history, we have no future". The quest for a legacy in the future is the only explanation and motivation for advancement of an institution. It is a pride moment for all of us in reaching a milestone of existence. KSCAA enters its 60th year bursting with new hope, expectations and renewed energy. We have launched new knowledge programs to cater to our members and are planning to bring forth interesting events in the coming months! We hope to keep you engaged and participate in KSCAA knowledge dissemination activities throughout the year. On this occasion of milestone, we salute our past presidents, mentors and members for their constant and untiring support.

Demonetization, talk of the town, is an economic event one of its kind. Its impact is felt by every Indian citizen. It's more than 4 weeks since the government announced the withdrawal of the old Rs 500 and Rs 1000 notes. This act of suasion on the part of Government to influence digital transactions by public at large has destructive impact on people unwilling to change their past business habits and vested interests. Now, one has to wait and watch the extent of change and influence on the world's fastest growing economy, whether this turns out to increase the GDP or would turn out to be a damp squib. By recalling 86 percent of circulating currency in a cash transaction driven to eradicate the pest of corruption, efficacy can be vouched in the coming months. The honourable Supreme Court has asked Government to address several issues such as reduction of withdrawal limits and hardship faced by public etc amidst the entire political ruckus. Also, misuse of the currency chest by few banks is making the headlines. I advise members who have accepted the concurrent audit assignment to exercise caution in discharge of such duty.

Representation:

An appreciable move of squeezing the new currency circulation, whether it is an unplanned or intentional one, we at KSCAA have given a representation to the Honourable Prime Minister explaining difficulties faced by professionals and public at large along with potential solutions. Now is the time for the state to administer and allow free play on the economy by the market forces; simplify, rationalize and reduce individual and corporate taxes as promised in first budget by Honourable Finance Minister; break into the 50th position in ease of doing business world index by automating processes and thereby reducing bureaucracy and their discretionary powers and encouraging voluntary compliance.

News Roundup:

ICAI has requested members not to indulge into any questionable practices which may bring disrepute to the profession and has further called upon members to render professional services within framework of the applicable laws and ICAI Code of Conduct, upholding and elevating the high standards enjoyed by the profession and keeping overall national interests in mind along with true spirit of the principle of ICAI - “Partner in Nation Building”.

In a step to bring in transparency, ICAI has issued mandatory Know Your Client (KYC) norms to all members of the Institute of Chartered Accountants of India (ICAI), who are in practice w.e.f. 1st January, 2017. Members requested to be abreast with the requirements of KYC as per ICAI Mandate.

Another key development I wish to highlight is about the Bankruptcy Code, 2016, where in the resolution processes are to be conducted by the Insolvency Professionals, required to be members of an Insolvency Professional Agency which in turn is to be registered with the Insolvency and Bankruptcy Board of India. The opportunity herein for our members is enormous in the days ahead.

The Centre and States have failed to arrive at consensus on jurisdiction in the recent GST council meet and have agreed to meet again on December 22 and 23, dashing hope that the crucial bills would be introduced in the ongoing winter session of Parliament and making it tough to meet the April 1 rollout for GST across the country. With the demonetisation drive, the states like West Bengal have argued that the drive would impact GST revenues. Also, Tamil Nadu, Kerala and Bihar have sought administrative control over both goods and services below the Rs 1.5 crore threshold. However the Finance Minister is confident to meet April 1 rollout date for the key reform.

Upcoming Events & Programs for the month:

I extend a warm welcome to all members to “Jnana Sangam – Knowledge Enlightment”, a seminar on GST and TDS Provisions under Income Tax Act, 1961 to be held on 16th December 2016 at Bagalkot. This seminar has been organised jointly with Bagalkot District Chartered Accountants Association for the benefit of mofussil members, I request you to make the most of this event.

Government has launched GST Portal for the enrolment of existing taxpayers of VAT, Service Tax and Excise for smooth transition to GST. This activation drive has given deadline of 15th January 2017 to traders to enrol themselves. KSCAA is organising Interactive Session for the benefit of professionals and traders on 2nd January 2016. Members are requested to attend this program as Departmental and Professional representatives will address the audience on the procedure.

The Basavanagudi CPE Study Circle is organising Study Circle Meeting, Discussion on Demonetization & Black Money on 23rd December. Expert speaker from the profession is addressing the participants and I request you to make use of this contemporary knowledge sharing event.

The details of these above programs are published elsewhere in the news bulletin for your benefit.

The words of our great scientist and minimalist beloved ex-President of India A.P.J. Abdul Kalam, I recall here- "Thinking should become your capital asset, no matter whatever ups and downs you come across in your life." Thus, on the road to success, the rule is to always to look ahead. May you reach your destination, and may your journey be wonderful. Wishing you a very Happy and flourishing New Year and Makara Sankranti.

Always at your service!

CA. Raghavendra Puranik
President

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

email: kscaablr@gmail.com

Website: www.kscaa.com

BASAVANAGUDI CPE STUDY CIRCLE

CPE Programme for the month of December 2016

Discussion on Demonetization & Black Money

by **CA. Naveen Khariwal**

CPE 3 Hrs.

on ***Friday, 23rd December 2016***

at ***5:00 PM to 8:00 PM***

Fees: Rs. 200/- Member, Rs. 250/- Non-Member

Venue : ***Bangalore International Academy***

 # 244/C, 32 Cross, 2nd Main Road, 7th block, Jayanagar, Bengaluru - 560082

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CA. Nagappa Nesur - +91 98867 11611

Participation mail to: basavanagudicpe@gmail.com/ kscaablr@gmail.com

KARNATAKA STATE CHARTERED ACCOUNTANTS ASSOCIATION ®

Organizes

Interactive Session on

Migration of Existing Tax Payers under GST

by

Sri B.S. Biradar
ACCT (e-Administration) - 1, Bengaluru

CA. Annapurna Kabra

No Fees

on ***Monday, 2nd January 2017***

at ***5:00 PM***

Venue : ***Bangalore International Academy***

 # 244/C, 32 Cross, 2nd Main Road, 7th block, Jayanagar, Bengaluru - 560082

Contact:

CA. Raghavendra T N - +91 98801 87870
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GST – Impact on Inventory Management Function

CA. Madhukar N Hiregange and **CA. Mahadev R**

In addition to sales and procurement functions, inventory management would be crucial while transiting to new GST regime from existing indirect tax regime. Some of the aspects to be considered could be planning of purchases during transition, reconciliation of stock records etc. In this article, we have discussed few aspects having impact on inventory management function in GST. Professionals could take care of these aspects for guiding assesses in transition phase.

Planning before transition

There is a need to plan time of purchase during transition phase considering the factors such as credit eligibility, entry tax levy, days of delivery etc. Presently, the interstate purchases suffer 2% CST against Form C which is non-creditable. During transition phase, such purchases could be delayed by maintaining appropriate stock levels. In case entity has more interstate sales, then customers could also reduce purchase volume to save on CST cost. Therefore, stock requirements to be studied well in advance to plan for stock levels. The absence of check post would reduce the transit times also.

Despatch of rejected inventory

Rejected inventory needs to be returned to suppliers especially when the VAT input credit / Cenvat credit has been availed on such inventory. Otherwise the benefit of tax deduction or recredit may not be eligible for the supplier which ultimately burden the person returning the goods. Therefore, identification of inventory due for return to the suppliers is critical during transitional phase.

Meeting customers demand during transitional phase

There could be good demand for the goods which are presently liable for concessional rate of tax but subject to higher GST after introduction of GST. This demand could be from customers who would not be eligible for any credit or from final consumers. It is necessary to ascertain the level of finished goods to be maintained to meet customer's demand. Failing to meet demand of customers could lead to disappointment of customers and losing out on future orders. Appropriate planning could avoid losing out on any such orders.

Tracking of goods lying with job workers and agents

In the present indirect tax regime, inputs / capital goods can be removed outside the factory without paying any duties for carrying out any intermediary process, provided the goods are received back within 180 days in case of inputs and 2 years in case of capital goods. During transitional phase, the stock of goods lying in job work to be tracked and reconciled. Any deficiency in stock as per books of the entity and actual stock could lead to denial of credit. Early action during transition phase could avoid unnecessary demands in future.

The reconciliation exercise should be undertaken even for goods lying with agents. According to model GST law, the agents would be entitled to take credit on stock lying subject to condition that both principal and agents declare the details of stock appropriately. Reconciliation statements would help to ensure availing appropriate credits.

Demand for discount

There could arise a situation where there is a need to procure more goods before implementation of GST. If such a scenario arises, quantity / trade discounts could be demanded from the suppliers which would reduce the procurement cost of supplies. Comparing the tax rates as per the present rates in indirect taxes and tax rate in GST could be necessary to decide on such purchases.

Stock Transfer of goods

It is usual practice for most of the manufacturers to open branches in different places either within the state or outside the state for transport convenience or to avoid charging of CST which is non-creditable. Presently, transfer of excisable goods to other places including branches would be liable for applicable excise duties but not subject to VAT. In GST regime, all supplies including branch transfers would be subject to GST. This would have impact on cash flow. Therefore, the need for branches and level of inventory to be maintained at branches to be relooked during transitional phase.

Conclusion

The model / revised GST law is not as simple as one expected and above aspects are only illustrative which could vary for each organisation. Lot of planning is required during transitional phase for every organisations. Professionals like chartered accountants could highlight the importance of proper planning in GST including inventory management for the clients to maximize the benefits.

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Audit Aspects under the Karnataka VAT law - VAT 240

CA. Sanjay Dhariwal and CA. Annapurna D Kabra

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. Verification of records in the context of audit is a vital importance as it would assist the Auditor to satisfy themselves as to statutory compliances, appropriate payment of taxes due to the Government, identify the aspects of revenue leakages if any and also to understand the business and trade. In that direction it would be essential for the Auditor in the course of audit to undertake verification of records of the dealer/assesses. The exercise of verification of records is very wide in scope and it cannot be standardized for all the dealers/assesses. Therefore it is always felt that the said verification process should standardized industry wise, size of the dealer, etc. As a part of the said verification of records exercise, it may be essential to undertake various processes.

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.

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. 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 end of the relevant year. The due date for filing the KVAT Audit Report shall be 31st December 2016 for the financial year 2015-2016. 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 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 KVAT Audit Report (Form VAT 240) has been bifurcated between the Certificate and the report. 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. The Author in the following paragraphs will discuss the issues during the KVAT Audit and their views may differ with different schools of thoughts.

I) <u>Financial statements</u>

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.

II) <u>Reconciliation of contents of Form VAT 240 with the financial statements.</u>

It would also be essential for the auditor to reconcile the figures which are disclosed in the returns and the figures reported in the financial statements. The said annual reports would consist of various information relating to sales, purchases and other incidental transactions which would also have a direct impact on VAT. However the challenge would be to compare the values reported therein Vis–a- Vis the values declared in VAT returns for many reasons. One of the important reasons would be that in cases of operations beyond the territory of the state, financial statements would be for the entire entity and not only for one state. Further also the reporting in financial statements may be based on various accounting methodology and not necessarily based on point of taxation as per VAT law. Therefore wherever the values in the financial statements may not match with the values declared in the returns reconciliation of the said values become essential. The reconciliation may have to be made considering various factors leading to differences. Some of the aspects, which need to be considered therein, are.

- Sales outside state to be excluded;
- Accounting done in the financials based on accrual basis but sales are not effected yet;
- Effects given in the financial statements for the events occurring after the balance sheet date.
- Accounting effects given in terms of accounting standards but those or neither sale or purchase as per VAT laws.
- Sales Returns shown in the accounts may be even for the period beyond 6 months whereas the amount that can get credit is pertaining only to sales returns for the period within 6 months.

III) <u>Ratio Analysis:</u>

Ratio analysis is a widely used tool for analysis of the financial data by giving a broad ratio between the set of financial figures. This will help the authorities to save their time in the process of verification of records of the dealer. Some of the important ratios from VAT law perspective are - Gross profit ratio; Input tax credit to output tax ratio; Net profit ratio; Stock turnover ratio; Output Tax to sales ratio; Input tax credit to Purchases ratio; Proportion of Ineligible Input credit to Total Input tax credit; Wastage to production ratio; yield ratio etc.

IV) <u>Sale of Fixed Assets</u>

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. The rate of tax is same, whether it is for the sale of used assets or sale of new assets. However if the Asset is sold as scrap then the rate will be different than original goods. Used goods would sell for a value much less than the new goods. VAT is levied on the considerations received. However in the financials the deletion column will show the amount which includes the accumulated depreciation and also the sale consideration received on sale of assets. The VAT is levied only on the sale consideration of asset and not on the value of deletion shown in the financials. All sales / sales returns including sale of fixed assets, if any, have been duly classified and properly accounted in the fixed assets register with respect to additions, deletions. The sale of fixed assets has been properly reflected in the returns filed. 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. Even if there is sale of assets to employees of company it is liable to tax.

V) <u>Monthly Details</u>

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.

VI) <u>Statutory Forms</u>

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.

VII) <u>Classification of goods</u>

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. VAT law has adopted the Central Excise Commodity classification for ascertaining the effective output VAT rates by way of referring to the same in Third Schedule and Exemption Notification. HSN is international classification System which is adopted in most of the Countries for the purpose of commodity classification. In India both Central Excise and Customs have adopted the same and have set out the classification accordingly in the schedules to the respective Tariff Acts. The coding system is designed with Eight digits wherein First two digits indicate the chapter in which the goods are classified: the next two digits indicate the heading in which the goods are classified: the next four digits indicate the further classification within the heading. The schedule to the Tariff Acts gives the rules of interpretation based on which the classification of goods has to be made. The section notes and chapter notes in the said schedules, would also guide the determination of classification. Further explanatory notes to HSN which is internationally followed would also guide the classification. Already decided cases pertaining to classification under the Central Excise law may be referred to ascertain the classification to determine the proper rate.

VIII) <u>Eligibility of input tax credit as per Special rebate or Partial rebate formula</u>

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.

IX) <u>Other Key aspects to be verified</u>

In addition to the general analysis of records of the dealer, there may be requirement to verify some of the specific areas which requires special attention. Some of the important areas which require special attention are as follows:

- Sales return – Whether the goods have come within 6 months and the conditions for taking credit of the same are fulfilled.
- Discount, Freight Tax etc.,– Whether the discount, freight and other elements shown separately in the invoice is considered as part of taxable value or not if not whether the conditions for claiming exclusion are fulfilled.
- Claiming Labour Expenses on Actual or Adhoc basis
- Sub-contractor deductions: Whether sub-contractor have paid the taxes and filed the return
- Methodology adopted for computation of Gross Turnover and Taxable Turnover.
- The Payment of the taxes can be made along with the KVAT Audit Report accordingly.
- The Auditor has to highlight the details of Department Visits.

(Contd. on page 10)

INDIRECT TAXES UPDATE – November 2016

CA C.R. Raghavendra *B.Com, FCA, LLB, Advocate* and
CA Bhanu Murthy J.S. *B.Com, FCA, LLB, Advocate*

FOR THE MONTH OF NOVEMBER 2016:

Circulars / Clarifications / Notifications

1. **Online information and database access or retrieval services:**

   In case of 'Online Information and Database Access or Retrieval Services' (OIDARS) the recipient of service is made liable to pay service tax under 'Reverse Charge Mechanism' when imported by person other than 'non-assessee online recipient"

   Relevant amendments have been made in Service Tax Rules, 1994 amended by Notification No.48/2016-ST dated 9.11.2016 – w.e.f., 1.12.2016:

   '(ccd) "online information and database access or retrieval services" means services whose delivery is mediated by information technology over the internet or an electronic network and the nature of which renders their supply essentially automated and involving minimal human intervention, and impossible to ensure in the absence of information technology and includes electronic services such as,-

(i) advertising on the internet;

(ii) providing cloud services;

(iii) provision of e-books, movie, music, software and other intangibles via telecommunication networks or internet;

(iv) providing data or information, retrievable or otherwise, to any person, in electronic form through a computer network;

(v) online supplies of digital content (movies, television, music, etc)

(vi) digital data storage; and (vii) online gaming;"

   (ccba) "non-assesse online recipient" means Government, a local authority, a governmental authority or an individual receiving online information and database access or retrieval services in relation to any purpose other than commerce, industry or any other business or profession, located in taxable territory;

- Where online information and database access or retrieval services are received by 'non-assessee online recipient', then service tax has to be discharged by the service provider located outside India.
- Further, detailed provision is set out to make the 'intermediary' / broker / agent etc of foreign service provider to be responsible for payment of service tax as 'recipient of service' subject to conditions.
- Intermediary of foreign service provider is deemed to be liable to pay service tax EXCEPT when intermediary satisfies **all** the conditions:

(a) the invoice or customer's bill or receipt issued or made available by such intermediary taking part in the supply clearly identifies the service in question, its supplier in non-taxable territory and the service tax registration number of the supplier in taxable territory;

(b) the intermediary involved in the supply does not authorise the charge to the customer or take part in its charge i.e. intermediary neither collects or processes payment in any manner nor is responsible for the payment between the non-assesse online recipient and the supplier of such services;

(c) the intermediary involved in the supply does not authorise delivery;

(d) the general terms and conditions of the supply are not set by the intermediary involved in the supply but by the service provider:

- Where service provided by foreign service provider and received by any person in the taxable territory, person receiving such services shall be deemed to be located in the taxable territory if any two of the following non-contradictory conditions are satisfied:

(a) the location of address presented by the service recipient via internet is in taxable territory;

(b) the credit card or debit card or store value card or charge card or smart card or any other card by which the service recipient settles payment has been issued in the taxable territory;

(c) the service recipient's billing address is in the taxable territory;

(d) the internet protocol address of the device used by the service recipient is in the taxable territory;

(e) the service recipient's bank in which the account used for payment is maintained is in the taxable territory;

(f) the country code of the subscriber identity module (SIM) card used by the service recipient is of taxable territory;

(g) the location of the service recipient's fixed land line through which the service is received by the person, is in taxable territory:

Person receiving such services shall be deemed to be a non-assessee online recipient, if such person does not have service tax registration under these rules.

[Source: Service Tax Rules, 1994 amended by Notification No.48/2016-ST dated 9.11.2016 – w.e.f., 1.12.2016]

2. **Online information and database access or retrieval services -Exemption 25/2012-ST amended:**

In the entry no.34 of the Mega Exemption Notification, a proviso has been inserted as under:

Sl. No.34 – Services received from a provider of service located in a non-taxable territory by –

(a) Government, a local authority, a governmental authority or an individual in relation to any purpose other than commerce, industry or any other business or profession;

"Provided that the exemption shall not apply to online information and database access or retrieval services received by persons specified in clause (a) ;";

Exemption granted Government, local authority, governmental authority or to an individual has been made inapplicable to OIDARS.

[Source: Notification No.47/2016-ST dated 9.7.2012]

3. **Online information and database access or retrieval services – Amendment of Place of Provision of Service Rules:**

Rule 3 amended – to exclude 'Online information and database access or retrieval services' from the proviso.

Rule 9: The place of provision of specified services shall be the location of service provider. Clause (b) – "Online information and database access or retrieval services" is omitted

Place of provision of service for OIDARS would be the location of the recipient

[Source: Notification No.46/2016-ST dated 9.7.2016]

4. **Exclusion of 'Online information and database access or retrieval services' from the definition of 'Telecommunications services':**

The Place of Provision of Services Rules, 2012 has been amended wherein the definition of 'Telecommunication services' in clause (q) has been amended to exclude 'online information and database access or retrieval services'.

[Source: Notification No.51/2016-ST dated 30.11.2016]

5. **Exemption of bank charges up to Rs.2,000/- when transacted through Debit Card, Credit Card or other payment card:**

The Mega Exemption notification No. 25/2012-ST dated 20.06.2012 is amended so as to exempt services provided by the bank (bank charges) to any person in relation to settlement of an amount upto Rs.2,000/- in a single transaction transacted through credit card, debit card, charge card or other payment card service.

[Source: Notification No.52/2016-ST dated 8.12.2016]

Case laws:

1. **Gujarat State Fertilizers And Chemicals Ltd Vs CCE 2016-TIOL-198-SC-ST**

In this case, in order to enable Gujarat Alkalies & Chemical Ltd. (GACL) to receive this Hydro Cynic Acid (HCN) through common pipeline, the arrangement/agreement was entered into between the assessee GSFC and GACL. For the purpose of receiving HCN through common pipeline, the handling facilities were installed in the premises of Gujarat State Fertilizers And Chemicals Ltd (GSFC). For installation of these facilities both the parties had contributed towards the investment. Since the said handling facilities are in the premises of GSFC, incineration also takes place at the said premises. Handling facilities expenditure thereof is shared equally by both the parties. These aspects were clearly provided in the agreement/arrangement that was agreed to between the parties and is reflected in the Minutes dated 06.07.1980. Considering the above facts, Supreme Court held that once these facts are accepted, the handling portion and maintenance including incineration facilities is in the nature of joint venture between two of them and the parties have simply agreed to share the expenditure. It was held that sharing a common storage facility does not amount to one party providing a service to another. Accordingly, the payment which is made by GACL to GSFC is the share of GACL which is payable to GSFC. Supreme Court held that by no stretch of imagination, it can be treated as common 'service' provided by GSFC to GACL for which it is charging GACL and allowed the appeal in favour of the assessee.

2. **CST Vs Jet Airways India Ltd 2016-TIOL-210-SC-ST**

In this case, Hon'ble CESTAT by Majority in 2015-TIOL-2329-CESTAT-MUM had held that the excess baggage charges collected by airlines are an integral part of the main service, namely 'transportation of passengers by air' and, therefore, the demand of service tax under the category of *"Transportation of Goods by Air"* was not sustainable; that extended period of limitation is not invokable and that penalties cannot be imposed.

Against the above decision, the Department had filed an appeal before Supreme Court. Supreme Court while condoning the delay in filing of appeal by Revenue, dismissed the Civil Appeal filed by Revenue. Accordingly, the order of Tribunal is upheld by the Supreme Court.

3. **Arvinth Hospitals Vs ADDL CCE 2016-TIOL-2838-HC-MAD-ST**

In this case, the petitioner was engaged in providing medical treatment and health checkup services under Government Welfare scheme called "Kalaignar Kaapittu Thittam" (KKT) under which all hospital were required provide medical treatment for people in lower income groups. The management/implementation of this scheme was entrusted to Star Health and Allied Insurance Company Limited. Department sought to demand service tax from the petitioner alleging that the treatment services rendered under KKT scheme is taxable as "Health Check up and Treatment Services" as the entrustment of welfare scheme to an insurance agency per se makes it an insurance policy. In this regard, Hon'ble High Court held that the notice which proposes to demand service tax is erroneous since it has been issued without examining the true nature of the relationship between the parties involved, scheme vis-à-vis nature of transactions done by petitioner with beneficiaries. Accordingly, the impugned order is set aside and the matter is remanded to reconsider the entire issues afresh.

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Audit Aspects under the Karnataka VAT law - VAT 240

(Contd. from page 7)

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

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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16	Ameetkumar Prakashchandra Jain	Bagalkot

Foreign Tax Credit Rules – a welcome effort (Part 2 of 2)

CA. Prakash Hegde and **CA. Raghavendra N**

....Continued from the last News Bulletin....

In the first part of this article, we had discussed the provisions of the newly introduced Rule 128 in the Income Tax Rules, 1962 ('the Rules) on Foreign Tax Credit ('FTC'). In this part of the article, we have analysed those provisions to understand their impact.

As provided in sub-rule 1 of Rule 128, FTC shall be allowed by a resident of India if the foreign tax has been 'paid' in a foreign country (or specified territory) and the corresponding income is 'offered to tax' or 'assessed to tax' in India.

In a recent landmark decision in the case of *Wipro Ltd.* v. *Dy. CIT [2015] 62 taxmann.com 26* (which was rendered before the introduction of Rule 128) the Karnataka High Court ('HC') had held that FTC for federal tax paid in USA should be allowed under the Double Taxation Avoidance Agreement ('DTAA') between India and USA even if that income is exempt in India under section 10A of the Income Tax Act, 1961 ('the Act'). The logic behind the decision of the HC was that the income derived by a unit eligible to claim exemption under section 10A of the Income Tax Act, 1961 ('the Act') is chargeable to tax under section 4 of the Act and therefore, covered under the scope of total income prescribed in section 5 of the Act. But no tax is charged because of the exemption granted under section 10A of the Act for a limited period of 10 years. Merely because the exemption has been granted, it cannot be considered that the assessee is not liable to tax as the said exemption granted had the effect of suspending the collection of tax only for a period of 10 years and therefore, the assessee's case is falling under section 90(1)*(a)(ii)* of the Act. India-USA DTAA does not speak about any tax being paid in India as a condition precedent for claiming the FTC.

It may be noted that the terms 'offered to tax' or 'assessed to tax' in sub-rule 1 of Rule 128 are subject to interpretations, which may open up another set of litigation on this matter.

The other important aspect to be noted in this context is that different countries follow different periods as their tax years. For e.g. US, Canada and many European countries follow calendar year (i.e. from January to December) as their tax year whereas Australia follows July to June as its tax year. Therefore, income offered to tax in such countries in their tax year may have to be distributed over two tax years in India. To address such a situation, the sub-rule provides that FTC shall be allowed in proportion to the income offered to tax in India in a particular year.

It should also be noted that the year in which a particular income is taxed in India and in a foreign country could be different as the trigger for taxation of the same could be different under the tax laws of different countries. However, sub-rule 1 makes it abundantly clear that the year in which FTC is available in India for the taxes paid in the foreign country is the year in which the corresponding income is offered to tax or assessed to tax in India. But a catch lies here as the term used in the sub-rule is 'foreign tax paid'. In many countries, the tax payer has to file his tax return computing the tax liability. However, the actual tax payment has to be made only after the tax authorities complete the assessment. Therefore, there could be a time gap between filing of the tax return and the payment of taxes. Under the provisions of this sub-rule, FTC is allowed only for the foreign tax paid!

Sub-rule 2 specifies the meaning of 'foreign tax' paid in a foreign country against which FTC would be available in India. It states that where India has entered into a DTAA with that country, foreign tax shall be the taxes covered under that DTAA. Where no DTAA has been entered in to, foreign tax shall mean tax payable under the law in force in that country on the profits (referred to in clause (iv) of the Explanation to section 91).

In this context too, it would be relevant to refer to the decision of the Karnataka High Court ('HC') in *Wipro Ltd.* v. *Dy.CIT* supra in which the HC has ruled that even though state taxes are not covered in the DTAAs which India has entered into between USA / Canada, the assesse is eligible to claim FTC for State taxes paid in USA / Canada in accordance with section 91 of the Income Tax Act.

Sub-rule 3 has clarified that FTC is not available against amount of interest, fee or penalty. This may reduce ambiguity amongst Indian taxpayers and could reduce litigation.

Sub-rule 5 states that FTC shall be computed separately for each source of income arising from each country. This approach will complicate the FTC computation where the foreign taxes are computed after allowing certain lump sum deduction (not specifically related to a source of income) under foreign tax laws. In such a situation, one has to pro-rate the deduction to each source of income to arrive at the foreign taxes on such income.

Though sub-rule 6 provides that FTC can also be claimed in respect of taxes in the nature of MAT / AMT, there is absence of further clarity since there could be mismatch in the base on which income tax is payable under MAT / AMT and taxes paid in the foreign country. If FTC available is higher than the MAT / AMT credit, the lower amount shall be considered.

Few situations not addressed in the new Rule

There may be a situation where the foreign tax authorities may enhance the amount of tax payable by an assessee in their country. As a result, the assessee may have to pay the enhanced amount of tax subsequent to the last date for filing a revised return in India for the year in which he has offered that income to tax. In such a situation, though legitimately he is entitled for a higher amount of FTC, he may not be able to claim the same as the newly inserted Rule has not addressed this situation.

There are many residents of India who are employees of Indian employers and are eligible for FTC for the taxes paid in a foreign country on their salary. If such FTC is considered by their Indian employers at the time of deduction of tax on their salary (under section 192), it would have been convenient as otherwise, these employees have to claim the FTC in their return and wait until they receive the refund from the income tax authorities. This leads to cash-flow issues for such employees. However, the newly inserted Rule has not addressed this situation as well.

One of the aspects which the Rules lack to address is the claim of FTC on the enhanced tax liability of the tax payer by the Assessing Officer during the assessment proceedings. Where an Assessing Officer, based on the assessment proceedings, makes any addition to the tax payer's income resulting in an increase in tax liability, the question would arise if the FTC claimed by the tax payer in his tax return would also be enhanced, in light of increase in tax liability. This issue has not been addressed in the Rules.

Many countries including USA allow the assessees to carry forward the unutilized foreign tax paid to be set off appropriately in the future. Without this, the assessee's will permanently lose the unutilised foreign tax paid. But the newly introduced Rule has not allowed such carry forward.

Conclusion

Despite few shortcomings in the newly inserted FTC provisions as noted above, it may be viewed that these provisions have addressed some of the very important aspects of FTC and have brought clarity which can help reduce litigation.

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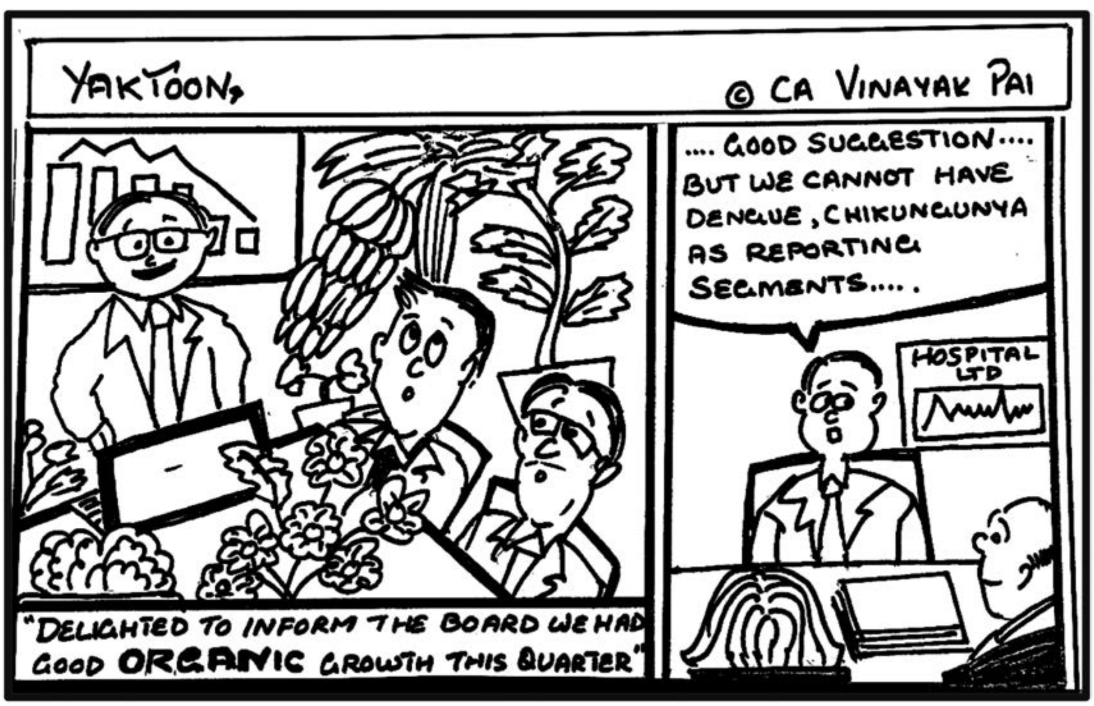

Financial Reporting – Practitioners Update

CA. Vinayak Pai V

1. Introduction

Indian corporates, other than those that had dual GAAP reporting, face IND-AS implementation challenges emanating from **new accounting concepts and models** that were non existent under the AS regime. Accounting for share based payment arrangements, acquisition method of accounting, valuation of financial assets, component accounting for financial liabilities, accounting for derivatives, hedge accounting, evaluation of control model, component accounting for revenue, fair valuations are a few examples that could trigger the implementation and steady-state reporting challenges for in-scope companies.

While the IND-AS implementation and auditing challenges are surmountable, haphazard implementation could result in **internal controls over financial reporting** becoming a casualty at the date of transition and in the preparation of the first IND-AS financial statements. Proper planning, oversight and process management is a pre-requisite and the transition responsibility is that of management. Auditors need to **watch out for pitfalls in internal controls** over **IND-AS** financial reporting **migration**.

2. Financial Reporting Updates

a) Revenue under ICDS (Revised)

Revised Income Computation and Disclosure Standards (ICDS) are **applicable from Assessment Year 2017-18** and the salient incremental aspects of revenue topics viz. ICDS III- *Construction Contracts* and ICDS IV – *Revenue Recognition* is provided herein below.

- **Construction Contracts**

  Recognition of contract revenue and costs with respect to **open contracts** as of March 31, 2016 should be based on the accounting **method regularly followed** in 2015-16 as per the transitional provisions.

- **Service contracts**

- Where services are provided by an **indeterminate number of acts** over a specific period of time, revenue **may** be recognized on a **straight-line basis** over the specific period.

- Where service contracts are for durations of **less than 90 days**, then the related revenue **may** be recognized when the service is **substantially complete/complete**.

- Transitional provisions applicable to open service contracts in same manner as applicable for construction contracts.

- **Interest income**

  Interest on **refund** of taxes/duties/cess would be deemed to be income of the previous year of **receipt.**

b) Accounting for bearer plants (non IND-AS)

The Companies (Accounting Standards) Amendment Rules, 2016 were notified on March 30, 2016 and is applicable for the audit of financial statements of entities for the **current fiscal ending March 31, 2017**. A related amendment is the accounting for bearer plants governed by AS 10 – *Property, Plant and Equipment* (PPE). The salient aspects are discussed herein below.

- Bearer plant is a plant that is a) **used in the production** or supply of agricultural produce, b) is **expected** to **bear produce** for **more** than a period of **twelve months** and c) has a **remote likelihood** of being sold as agricultural produce, except for incidental scrap sales.

- Bearer plants are a **separate class** of PPE

- AS 10 applies to bearer plants but **does not apply to the produce of bearer plants.**

- Bearer plants are required to be accounted in the **same manner as self-constructed items** of PPE before they are in the location and condition necessary to be capable of operating in the manner intended by management.

c) Amendment to Schedule II of Companies Act

- The Ministry of Corporate Affairs vide Notification No. GSR 1075(E) dated November 17, 2016 amended Schedule II (Depreciation) to the Companies Act.

- Accordingly, for amortization/depreciation of **intangible assets**, the relevant **IND-AS would apply**.
- It may be noted that IND-AS requires **one category** of intangibles to be **subject to amortization accounting** and **another category** to be **tested for impairment annually** without amortization charge.
- For non IND-AS preparers, the applicable AS would apply.

d) **Accounting Standards on Financial Instruments (AS) withdrawn**

Our Institute vide communiqué dated November 15, 2016 has **withdrawn** the following Accounting Standards and announcements:

i. **AS 30** – *Financial Instruments*: *Recognition and Measurement*

ii. **AS 31** – *Financial Instruments: Presentation*

iii. **AS 32** – *Financial Instruments: Disclosures*

iv. **Announcement** – Application of AS 30 – *Financial Instruments: Recognition and Measurement*

e) **Audit Opinion on Financial Statements – Changes to SA 700**

The revised Standard on Auditing **(SA) 700** – *Forming an Opinion and Reporting on Financial Statements* is effective for **audits** of financial statements for periods beginning on or after **April 1, 2017.** Some of the salient aspects of the same are highlighted herein below.

- The **first section** of the auditor's report to include the **auditors opinion.** At present, the opinion section follows the sections on management's responsibilities for financial statements preparation and the auditor's responsibilities.
- The **Basis of Opinion** paragraph is a must even when expressing an **unmodified opinion**.
- While expressing an unmodified opinion, the basis of opinion should explicitly state whether the **auditor believes** that the audit evidence the auditor has obtained is **sufficient and appropriate to provide a basis** for the auditor's opinion.
- New section on communication of Key Audit Matters **(KAM)** (SA 701 – New) that is applicable only for **audit of listed entities**.
- Consequent changes related to SA 570 – *Going Concern* reporting.
- Elaborate description of **auditors responsibilities** including
  - o Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.
  - o To conclude on the appropriateness of the management's use of the going concern basis and whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.

f) **Planning for unlisted companies IND-AS transition in 2017-18**

Unlisted companies with a net worth in the range of Rs. 250-500 crore (as of March 31, 2014) move to IND-AS from April 1, 2017, albeit the date for preparing the opening IND-AS balance sheet is April 1, 2016. The preparation of the opening IND-AS balance sheet involves certain key steps as detailed herein below.

a. **Recognition** of all assets and liabilities whose recognition is **mandated** by the 40 IND-AS.

b. **De-recognition** of assets and liabilities that were recognized under AS but are **prohibited from recognition** under the IND-AS framework.

c. **Re-classification of balance sheet items** that were recognized per "AS" as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity as per IND-AS framework.

d. Analyzing and applying **voluntary choices** available for select line items at the date of transition.

e. Application of **IND-AS in measurement** of recognized assets and liabilities.

f. Presentation of Statement of Profit and Loss and Balance sheet in line with IND-AS compliant section of **Schedule III** to the Companies Act taking into consideration accounting aspects related to other comprehensive income section.

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Procedural Aspects of Establishment a Liaison Office (LO) Branch Office (BO)/ Project Office (PO) in India by Foreign Entities

CA. Adithya Bharadwaj S P

Recently, on 12 May 2016, the Reserve Bank of India (RBI) procedural guidelines regarding establishment of a LO/BO/PO by foreign entities. This was issued as a guidance under Foreign Exchange Management (Establishment in India of a branch office or a liaison office or a project office or any other place of business) Regulations, 2016. A brief snapshot for the same is as under:

<table>
<tr><th>Sl. No</th><th>Nature</th><th colspan="3">Explanation</th></tr>
<tr><td rowspan="3">1.</td><td rowspan="3">Eligibility to establish LO/ BO/PO</td><th>LO</th><th>BO</th><th>PO</th></tr>
<tr><td>Financial Track Record
The applicant (foreign entity) shall have a profit making track record during the immediately preceding three financial years in the home country and net worth of not less than USD 50,000 or its equivalent</td><td>Financial Track Record
The applicant (foreign entity) shall have a profit making track record during the immediately preceding five financial years in the home country and net worth of not less than USD 100,000 or its equivalent</td><td rowspan="2">A foreign company may open project office/s in India provided it has secured from an Indian company, a contract to execute a project in India, and the project is
• the project is funded directly by inward remittance from abroad; or
• the project is funded by a bilateral or multilateral International Financing Agency; or
• the project has been cleared by an appropriate authority; or
• a company or entity in India awarding the contract has been granted term loan by a Public Financial Institution or a bank in India for the Project.</td></tr>
<tr><td colspan="2">If the applicant does not meet above criteria, then the parent company may provide a Letter of Comfort subject to the condition that the parent company satisfies the prescribed criterion for net worth and profit and which would fund the operations if required.</td></tr>
<tr><td>2.</td><td>Application</td><td colspan="3">• Application shall be made in Form FNC to an AD Category – I bank who may grant the approval.
• Prior approval of RBI is required under following cases:
o applicant is a citizen of or is registered/incorporated in Pakistan
o applicant is a citizen of or is registered/incorporated in Bangladesh, Sri Lanka, Afghanistan, Iran, China, Hong Kong or Macau and the application is for opening a BO/LO/PO in Jammu and Kashmir, North East region and Andaman and Nicobar Islands
o The principal business of the applicant falls under Defense*, Telecom, Private Security and Information and Broadcasting
o The applicant is a Non-Government Organisation (NGO), a Non-Profit Organisation, or a Body/ Agency/ Department of a foreign government.
In case of opening of a PO related to defense sector, no separate approval is required if the non-resident applicant has been awarded a contract by/ or entered into an agreement with Ministry of Defense or Service Headquarters or Defense Public Sector Undertakings.
• A fresh FNC along with justification should be submitted in case the foreign entity wishes to have additional offices.
• General permission is given to establish a BO in a Special Economic Zone to undertake manufacturing and service activities subject to conditions that BO is functioning in those sectors where FDI is allowed100%; compliance with Chapter XXII (Companies Incorporated Outside India) of Companies Act,2013</td></tr>
</table>

Sl. No	Nature	Explanation		
3.	**Validity of license**	**LO**	**BO**	**PO**
		Normally 3 years. However, in case of Non banking finance Companies (NBFC) and entities in construction and development sector (CDS), it shall be two years only.	Specific limits have not been specified in the regulations.	Upto the tenure of the project.
		Extension of license: - Extension shall be granted for another 3 years. No extension in case of NBFC and CDS. In these cases, upon expiry, the offices shall be closed down or converted into a Joint Venture or a Wholly Owned Subsidiary subject to FDI regulations.		
4	**Permitted Activities**	**LO**	**BO**	**PO**
		• Representing the parent company / group companies in India. • Promoting export / import from / to India. • Promoting technical/ financial collaborations between parent / group companies and companies in India • Acting as a communication channel between the parent company and Indian companies.	• Export/import of goods. • Rendering professional or consultancy services • Carrying out research work in which the parent company is engaged. • Promoting technical or financial collaborations between Indian companies and parent or overseas group company • Representing the parent company in India and acting as buying/ selling agent in India • Rendering services in Information Technology and development of software in India. • Rendering technical support to the products supplied by parent/ group companies. • Representing a foreign airline/ shipping company	• As per the terms of the contract based on which approval is granted.
5	**Bank Accounts**	**LO**	**BO**	**PO**
		• Can maintain only one bank account without prior permission of RBI. • Credits: o Funds from Head office through normal banking channels for meeting day to day expenses of LO o Refund of security deposits, taxes, duties, etc. o Sale proceeds of the assets of the LO • Permitted debits are only for local expenses of the office.	• No specific restriction on the number of accounts to be opened like in the case of LO. • Credits: o funds received from Head Office through normal banking channels for meeting the expenses of the office o Receivable arising from its business operations • Debits: Expenses incurred by the BO and towards remittance of profit/winding up proceeds	• Entity from Pakistan having a PO in India shall need prior approval from RBI. • Entities to whom contracts are awarded for project by Government authority/ Public Sector Undertakings may open without any prior approval. • PO's can also open non-interest bearing foreign currency accounts subject to certain conditions

<table>
<tr><th>Sl. No</th><th>Nature</th><th colspan="3">Explanation</th></tr>
<tr><td rowspan="2">6</td><td rowspan="2">Remittance of profits/ Surplus</td><td>LO</td><td>BO</td><td>PO</td></tr>
<tr><td>May not be permitted to remit funds outside India before closure</td><td>Permitted to remit post deduction of Indian Taxes and on production of requisite documents like
o Copy of audited balance sheet and profit & Loss account for the relevant year,
o A CA certificate certifying the manner of arriving at remittable profits and it does not include profits on revaluation of assets. The CA certificate should also contain that the profits are earned from permitted activities only.</td><td>Intermittent remittances possible on submission of following:
• copy of audited accounts
• Auditor certificate showing the manner of arriving at remittable surplus giving due effect to various liabilities and provisions
• Undertaking from the project that the remittance will not hinder the completion of project in India and shortfall if any will be met by inward remittance.</td></tr>
<tr><td>7</td><td>Acquisition of immovable property</td><td>May not be permitted</td><td colspan="2">Governed by Foreign Exchange Management (Acquisition and transfer of immovable property outside India) Regulations, since a BO/LO/PO would be treated as a resident under the Foreign Exchange Management Act,1999</td></tr>
<tr><td>8</td><td>Transfer of Assets</td><td colspan="3">May be permitted. An application to AD Category-I banker should be made.</td></tr>
<tr><td>9</td><td>Compliance</td><td colspan="3">• Annual Audit
• Annual Activity certificate to be submitted
• One time registration with the concerned State Police Authorities
• PAN should be obtained
• To be registered with Registrar of Companies (RoC)</td></tr>
<tr><td>10</td><td>Closure/ Winding up</td><td colspan="3">• Request shall be made to AD Category – I bank, with the following documents
o Copy of approval for establishing the office.
o Auditors certificate:
(a) On Manner of arriving at remittable amount supported by a statement of assets and liabilities of the applicant, and indicating the manner of disposal of assets
(b) Confirming all liabilities in India is paid or provided for.
(c) Confirming that no income accruing outside India has remained unrepatriated to India
o Confirmation from applicant/ Parent company that no legal proceedings are pending against the office.
o A report from RoC on compliance with applicable provisions of Companies Act, 2013
o Any other document as may have been specified at the time of approval.</td></tr>
</table>

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Sports & Talent Meet - 2016











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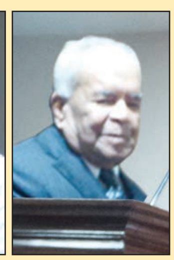
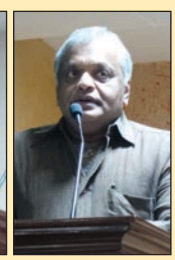


Speakers at Study Circle Meetings






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