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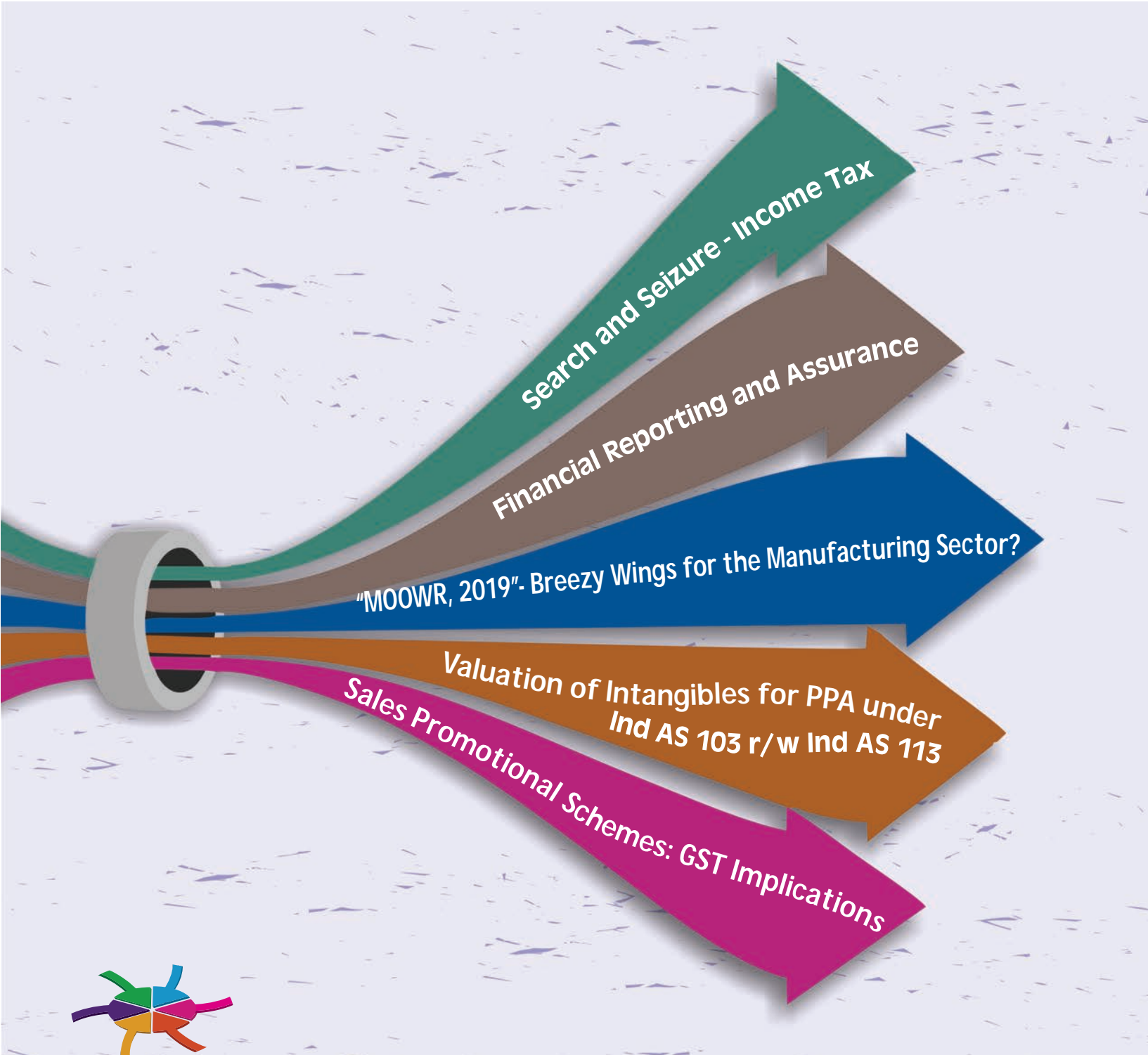
NEWS BULLETIN

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Search and Seizure - Income Tax

Financial Reporting and Assurance

"MOOWR, 2019". Breezy Wings for the Manufacturing Sector?

Valuation of Intangibles for PPA under  
Ind AS 103 r/w Ind AS 113

Sales Promotional Schemes: GST Implications



**CONVERGENCE**  
- Creating Impact Together



**Dear Professional friends,**

I presume you just completed an exhaustive year of tax audit and after you are back from Deepawali vacation, it's time to wrap up the learning and restore them for our upcoming professional requirement. It's probably that part of the year among the professional colleagues where the time to update and consolidate the

knowledge is highest.

The date 9<sup>th</sup> of Nov 2019 marks an important day among the citizens of this country, when the highest court pronounced its judgment on one of the most sensitive case in India. The Judgement marks the end of dispute which had kept the whole nation awaiting on its verdict. Let us all welcome the Judgement for all its fairness, close the awful chapter of whatever has happened and move to the paths of growth and prosperity of this great country. Let us also appreciate the maturity of the public in receiving this sensitive judgement.

Aggregator start-ups luring individual and small businessmen and professionals, had also roped in few Chartered Accountants in their site and mobile applications. They were placed along the side of technicians, maintenance workers, event organisers, etc. Recently, ICAI in its wisdom has accorded not allow such listing of names with aggregators. My fellow members are to be aware not to fault on this and refrain from such listing so as to not cause disrepute to the profession.

We had successful sports and talent and family meet event on 10<sup>th</sup> of Nov 2019, and some nail biting matches among our own members. The event witnessed extraordinary sportsmanship by CAs, and their family members and amazing talent show as well. We had to postpone the cricket and other outdoor activities to 24<sup>th</sup> of Nov 2019 due to imposition of section 144 in Bengaluru.

### **News Roundup**

#### **Goods and Service Tax**

The Honourable Supreme court's judgement in the case of Calcutta Club Ltd which confirms the existence of Principle of Mutuality in the case of Calcutta Club Ltd which is in relation to entities such as Clubs, Society's, etc. has a huge bearing on GST levy on such entities and our members could use this judgement for the benefit of their clients.

#### **Corporate and Business Law**

With an intention to improve corporate literacy and to create awareness among independent directors about their duties, MCA has introduced Online Proficiency Assessment Test for Independent Directors under the Companies Act, 2013 effective from 1<sup>st</sup> December 2019. This test will be conducted by Indian Institute of Corporate Affairs (IICA). The requirement will not be applicable for certain categories of individuals, including those who have served for at least 10 years as director or key managerial personnel in a company. Individuals, other than those

exempted, have to pass the test within one year from the date of inclusion of their names in the independent directors' data bank maintained by the IICA, as per the notification.

MCA has extended the due date of filing of forms MGT-7 (Annual return) and AOC-4 (Financial statements) under the Companies Act, 2013 to 31<sup>st</sup> December 2019 and 30<sup>th</sup> November 2019 respectively. MCA has also relaxed the additional fees of non-filing of MGT-7 and AOC-4.

### **Income Tax**

- CBDT has given clarification on set off of brought forward loss due to additional depreciation & MAT credit if companies opt for 22% tax.
- Domestic Companies opting for 22% tax are not eligible to set off of brought forward loss on account of additional depreciation.
- CBDT exempted authorized dealers & full-fledged money changer (FFMC) from TDS on cash withdrawals.
- CBDT notified protocol amending 'India - Morocco DTAA.
- CBDT has directed that the Income-tax Authority of Regional e-Assessment Centre (read as ReAC) to exercise the powers and functions of the Assessing Officer concurrently to facilitate the conduct of e-assessment proceedings

### **Upcoming Programs**

We have planned following programs in the month of November 2019

- Workshop on GST at Davanagere
- Workshop on GST Annual Returns & Audit at Bagalkot

### **Conclusion**

Confucius once said "Learning without thought is labour lost; thought without learning is perilous"

This is very interesting piece of advice to our CA practice, that we need to learn to acquire knowledge and the same knowledge needs to be applied to reflect on what is learnt and acquire more knowledge. Adventuring on something without learning and on uneducative impulse is a recipe for disaster. But together, and in balance, learning and thought give us a great way by which we can get things done. And that allows us to get it done with little wasted time or danger to self or others.

This harbours on the point that however a theory be, its relevance in the practical world is prominent and the harvest of the fruit is only when the same is applied successfully.

My Wishes to you all for a great learning and enriching experience.

Yours Sincerely,

**CA. Chandrashekara Shetty,**

President

# KSCAA

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November 2019

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# SEARCH AND SEIZURE – THE INCOME TAX ACT, 1961

CA. S. Krishnaswamy

A search which is conducted u/s 132 of the Income-tax Act 1961, is a serious invasion into the privacy of a citizen. Sec. 132(1) has to be strictly construed and the formation of the opinion or reason to believe by the authorising officer must be apparent from the note recorded by him. The opinion or the belief so recorded must clearly show whether the belief falls under clause (a), (b) or (c) of Section 132(1). No search can be ordered except for any of the reasons contained in clause (a), (b) or (c). The satisfaction note should itself show the application of mind and the formation of the opinion by the officer ordering the search. If the reasons which are recorded do not fall under clause (a), (b) or (c) then the authorisation under section 132(1) will have to be quashed.

**Pawan Kumar Goel vs. Union of India and Others (2019) 417 ITR 82 (P&H)**

The Income tax Act makes a special provisions for search and seizure in Sec. 132 which lays down the prerequisite for invoking the section.

Three conditions:

- The Authorised Authority.
- In consequence of information in possession as reason to believe.
- a. Any person has not complied with the Summon issued u/s 133(1).
- b. Any person who has failed to produce books of accounts and further documents.
- c. Any person is in possession of any money, bullion, jewellery or other valuable article or thing and such money, bullion, jewellery or other valuable article or thing represents either wholly or partly income or property which has not been, or would not be, disclosed for the purposes of the Act. *(There is a reference only to movable assets and not immovable property for obvious reasons.)*
- d. The rights of the Assessing Authority -
  - i. enter and search any building, place, vessel, vehicle or aircraft where he has reason to suspect that such

- books of account, other documents, money, bullion, jewellery or other valuable article or thing are kept;
- ii. break open the lock of any door, box, locker, safe, almirah or other receptacle for exercising the powers conferred by clause (i) where the keys thereof are not available;
- iii. search any person who has got out of, or is about to get into, or is in, the building, place, vessel, vehicle or aircraft, if the authorised officer has reason to suspect that such person has secreted about his person any such books of account, other documents, money, bullion, jewellery or other valuable article or thing;
- iv. require any person who is found to be in possession or control of any books of account or other documents maintained in the form of electronic record as defined in clause (t) of sub-section (1) of section 2 of the Information Technology Act, 2000 (21 of 2000), to afford the authorised officer the necessary facility to inspect such books of account or other documents;
- v. seize any such books of account, other documents, money, bullion, jewellery or other valuable article or thing found as a result of such search:
 

*Provided that bullion, jewellery or other valuable article or thing, being stock-in-trade of the business, found as a result of such search shall not be seized but the authorised officer shall make a note or inventory of such stock-in-trade of the business;*
- vi. place marks of identification on any books of account or other documents or make or cause to be made extracts or copies therefrom;
- vii. make a note or an inventory of any such money, bullion, jewellery or other valuable article or thing.

### Validity of a search:

- o A survey cannot be converted into search:
- 1. Pawan Kumar Goel vs. Union of India and Others (2019) 417 ITR 82 (P&H)-  
Summons were issued u/s 131 informing the assessee that the officials wanted to carry out a survey operation

u/s 133A. According to the assessee, during this procedure he voluntarily disclosed the liquidity/cash that he had in the premises to the extent of more than Rs.2 crores. The assessee also co-operated with the officials of the Department in providing them with the books of account, keys of lockers and all other necessary support during the survey. The assessee disclosed that the amount of Rs.2,09,89,090 was on account of advance that he had received from a reputed hospital in connection with this business. Although the summons indicated survey operations the procedure was converted into search and seizure.

The summons issued to the assessee was of a survey and as stated by him he voluntarily disclosed the retention of cash in his premises. In this situation, it was imperative upon the officials to have recorded their suspicion to indicate further action if they wanted to convert the survey into seizure. Besides, the summons issued to the assessee was totally vague. No documents were mentioned which were required of the assessee nor was any other thing stated. The income tax authority violated the procedure completely. Nowhere was any satisfaction recorded either of non-co-operation of the assessee or a suspicion that income had been concealed by the assessee warranting recourse to the process of search and seizure. **The proceedings were not valid.**

2. Laljibhai Kanjibhai Mandalia vs. Pr. DIT (Investigation) (2019) 416 ITR 365 (Guj):

3 conditions not satisfied:

1. No summons were issued
2. Not likely to respond to the summons
3. In possession of undisclosed cash

The only reason was that the assessee had advanced Rs.10 crores to the borrower company which was reflected in books of accounts and interest was also shown in the books of accounts; TDS was also been made. **No material on record found and held search invalid.**

Warrant of authorisation issued u/s 132 is subject to the conditions prescribed u/s 132(1). One of conditions is that there is no response to a summon or notice u/s 132(1) (a), but where no such notice had been issued, there is no justification for issue of authorisation for search in respect of this condition. Warrant of authorisation was completely quashed and set aside rendering all action pursuant to such authorisation invalid.

○ **Alleged statement under purchase price document related to another party showing a different purchase price of a proximate land:**

3. PCIT v Kulwinder Singh (2019) 415 ITR 49 (P&H)

During a financial year relevant to the AY 2009-10 the assessee purchased a piece of land from a seller. Search and seizure operations under section 132 were conducted at the premises of the seller and the assessee.

During the course of the assessment proceedings of the assessee under section 153A read with section 143(3), the AO found that the assessee had purchased the piece of land for a consideration of Rs.1 crore. During the course of the search conducted at the residential premises of the accountant of PISCO, certain documents and an agreement which showed the rate of the land at Rs.11.05 crores per acre were found. Since the land purchased by the assessee was part of the same land, the AO was of the view that the assessee had understated his investment in the land. The AO adopted the rate as shown in the agreement seized during the search of the third party and made an addition to the income of the assessee under section 69B as undisclosed investment. The AO also made an addition on account of disallowance of 12 per cent on the entire amount of interest on borrowed capital, under section 36(1)(iii) on the ground that the assessee had made interest free advances to his relatives and sister concerns. No explanation was given by the assessee. The CIT (A) held that the evidence relied upon by the AO represented a photocopy of an agreement to sell between two other persons in respect of a different piece of land on a different date, that the AO had proceeded on an assumption without a finding that the assessee had invested more than what was recorded in the books of account and deleted the addition.

The Tribunal held that the burden to prove understatement of sale consideration was not discharged by the Department, that the presumption of Assessing Officer could not lead to a conclusion of understatement of investment by the assessee and upheld the order passed by the CIT (A) and the appeal dismissed.

○ **Search without credible information is invalid:**

4. It was held by the Supreme Court in the case of CIT Vs. Vindhya Metal Corporation (1997) 224 ITR 614 that "Mere unexplained possession of the amount, without anything more, could hardly be said to constitute information which could be treated as sufficient by a

reasonable person, leading to an inference that it was income which would not be disclosed by the person in possession for the purpose of the Act.”

5. In Kavita Agarwal Vs. Director of Income Tax (2003) ITR 472 (All) the search of the premises of the Petitioner’s husband and his family resulted in the finding of keys to three lockers one of which stood in the couple’s joint names. The jewellery found in that specific locker was valued at Rs. 6,28,861. Yet, the Court was not prepared to accept that this by itself satisfied the requirement of the law. It held:

“The law is well settled that a warrant of search and seizure under Section 132(1) can only be issued on the basis of some material or information on which the Commissioner/ Director has reason to believe that any person is in possession of money, jewellery or other valuable articles representing wholly or partly income or property which has not been or would not be disclosed, under the IT Act. In the present case the respondents have not disclosed what was the material or information on the basis of which the Director/ Commissioner entertained the belief that the lockers contained valuable jewellery or other articles representing undisclosed income. It is well settled that the satisfaction of the authorities under Section 132 must be on the basis of relevant material or information. The word used in Section 132(1) are “reason to believe” and not “reason to suspect”. In the counter-affidavit it has been specifically stated in para 18 that the authorized officer had reason to suspect and not reason to believe.”

6. It was held by the Delhi High Court in the case of Ameeta Mahera Vs Additional Director of Income Tax (INV)-Unit And ANR vide W.P.(C) 1471/2013 order pronounced on 16<sup>th</sup> of May 2017 that-

“The Respondent’s search of the Petitioner was a classic case of a false start”. It was without legal basis. What

were the options available to the Respondents when they came across the locker key when they searched Mr Suresh Nanda? The first step was to seal the locker. In fact they did so by issuing an order under Section 132 (3) of the Act. However, instead of immediately jumping to conclusions against the Petitioner, and before actually searching the locker by lifting the restraint order, the Respondents ought to have investigated further and gathered some credible information that could lead them to form a reasonable belief that (i) she was linked to the activities of the Nanda Group and (ii) her locker might contain money, jewellery etc that constituted undisclosed income. Only then was a search warrant qua her justified. Alternatively, they may have opted to proceed against her under Section 153 C of the Act. That too would have required two Satisfaction Notes: one by the AO of the searched person followed by one by her own AO. However, in the present case, the Respondents did not opt for the alternative.”

It was held that search conducted on Locker No. 4979 by issuing an authorization dated 27<sup>th</sup> February, 2012 under Section 132 of the Act against the Petitioner was invalid. The said authorization is hereby quashed.

- **Reasons need not be communicated to the person against whom the warrant is issued at the stage:**

7. Adarsh Credit co-operative Society Limited vs. Jt. DIT (Investigation) (2019) 414 ITR 434 (Guj)

- **Conclusion:**

Warrant of authorisation for search must be based on credible information with reference to three conditions said down in section 132 of the Income Tax Act 1961.

*To be Continued..*

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## SALES PROMOTIONAL SCHEMES: GST IMPLICATIONS

CA. G. B. Srikanth Acharya

Various issues have been doing rounds with regard to the taxability of sales/business promotion schemes and the treatment of Input Tax Credit (ITC) thereon. There are several promotional schemes offered by taxable persons to increase sales volume and to attract new customers. We have tried to examine the taxability and availability of ITC in relation to such issues in this article.

To examine the same, we have taken into consideration below cases:

### Example 1

#### Free of cost items and gifts given to customers for business promotion

**Scenario:** A Dealer gives items such as pen, keychain, dairy, calendar, etc., having his name printed on it, free of cost to his customers, for business promotion.

**Taxability:** As per Sec. 7(1)(a) of the CGST Act, 2017, the expression “supply” includes, all forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be **made for a consideration** by a person in the course or furtherance of business. (Except for transactions mentioned in Schedule I of the CGST Act, 2017)

Accordingly, when a dealer gives items such as pens, diaries, key chains, etc., to his customer for business promotion, **without any consideration**, such transaction is **not “supply”** under GST and therefore, **not taxable**.

**Input Tax Credit:** As per Sec. 17(5)(h) of the CGST Act, 2017, ITC is not available in respect of goods lost, stolen, destroyed, written off or disposed of **by way of gift** or free samples. Therefore, **ITC cannot be claimed** on such transactions, where goods are disposed free of cost, that is without any consideration.

### Example 2

#### Free gifts to agents/distributor on completing certain targets

**Scenario:** A Supplier gives 10 Gold coins to his agents on achieving sales target of Rs. 1 Crore.

**Taxability:** For a transaction to constitute as supply, there has to be consideration. Transaction without consideration

is not supply and therefore not taxable under GST.

In the present case, the reward in the form of gold coins, given to the agent is on achieving a particular target as per the scheme, which **is under a contractual obligation** and it cannot be said that it is without any consideration. Moreover, a transaction with consideration cannot be artificially split to invent an activity without consideration as **the price of gold coins is allocated across the value of the sales target achieved**. In the example, gold coins are not being disposed off without any consideration, and GST is already being charged on the sales value under the target. Thus, **no GST should be levied on the said transaction**. However, in the order of Maharashtra Advance Ruling Authority, in the case of Sanofi India Limited, a similar transaction is considered as taxable under GST. **Therefore, taxability of the same is a disputable issue.**

#### Input Tax Credit:

As mentioned above, the agent gets gold coins based on the turnover target achieved by him. Also, the giving of reward in the form of **gold coins is a supply with consideration** and thus **input tax credit on gold coins should be allowed**.

### Example 3

#### Additional discount by manufacturer to dealer, to offer discount by the dealer to customer

**Scenario:** A manufacturer of medicines gives additional discount to the dealer to sell the medicines at a special reduced price to Hospitals.

**Taxability:** In the present scenario, **for the dealers**, there are two transactions. First is the supply of medicines to Hospitals; second, the receipt of compensation from supplier by way of discount. On the supply made to hospitals, valuation rules shall be applied and the tax amount shall be calculated on the discounted amount.

The main issue here is, whether the discount given by the supplier to dealer is consideration for supply, and whether it is taxable under GST? To address this issue, Circular No. 105/24/2019, dated 28<sup>th</sup> June, 2019 was issued, stating that the additional discount would represent consideration flowing from the supplier of goods (here, manufacturer) to the dealer, for supply made by dealer to the customer (here,

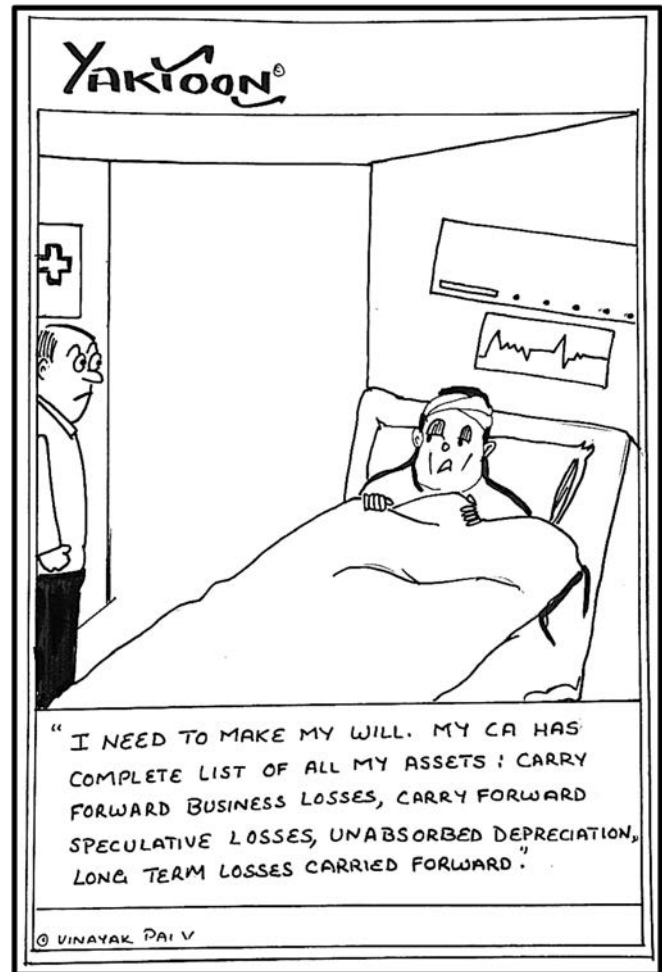
hospital). The circular further provided that this additional discount as consideration, payable by the supplier would be liable to be added to the consideration payable by the customer, for the purpose of arriving at the value of supply, in hands of the dealer.

There have been placed some rigorous representations before the concerned authorities on treatment of such post-sale discount. The CBIC issued Circular No. 112/31/2019 – GST, dated 3<sup>rd</sup> October, 2019, withdrawing ab-initio, Circular No. 105/24/2019. Now, **the taxability and treatment of such transaction under GST is in haze.**

**One thought of school** is that if such discount amount is taxable, then how will the transaction be routed and what will be the time of supply? Also, how and against what supply will the value be invoiced? Further, the definition of ‘consideration’ GST law does not include ‘discount’ as a ‘consideration’. Also, the Indian Contract Act, 1872, does not include ‘discount’ as ‘consideration’. Therefore, equating discount with consideration and charging GST on the same would go contrary with the definition of ‘consideration’. Charging GST to such discount amount would mean a break in ITC chain, where the value on which tax has been paid is not even realized either by the supplier or the dealer.

**Input Tax Credit:**

The circular 105/24/2019 stated that the customer, if registered, can claim ITC of tax charged by the dealer, only to the extent of tax paid by the said customer. The same holds good. However, the said circular has been withdrawn.



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# VALUATION OF INTANGIBLES FOR PURCHASE PRICE ALLOCATION REQUIREMENT UNDER IND AS 103 (BUSINESS COMBINATION) READ WITH IND AS 113 (FAIR VALUE MEASUREMENT)

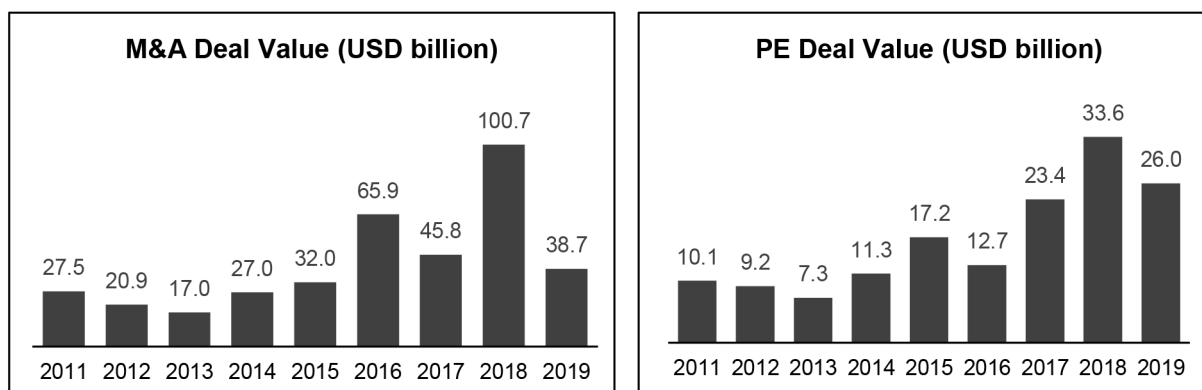
CA. Vikas Suresh

**Increasing role of M&A in the Indian business scenario and hence the accounting framework gearing up to provide relevant insights**

India has been witnessing a significant increase in M&A transactions and Private Equity transactions with value of total deals crossing over USD 100 billion in 2018. The total value of deals increased to USD 100.7 billion in 2018 from USD 27.5 billion in 2011 at a CAGR of 20.3 per cent and Private Equity deals have increased from USD 10.1 billion in 2011 to USD 33.6 billion in 2018 recording a CAGR of 18.7 per cent.

Sources: Secondary Research, Annual Reports, Venture Intelligence & Unithos Analysis

**Note:** 2019 numbers are till September 2019



Such transactions normally require deeper understanding of business value drivers and the value creation opportunities in the businesses for both the acquirers and the sellers to assess the feasibility of the deal and analyze rationale for possible synergies. Financial investors like Private Equities, Venture Capital identify the core strengths/value drivers of the businesses and prioritize investments in assets which can result in maximizing returns.

With an objective to facilitate availability of objective information for analysis, the financial reporting framework in India is evolving based on references drawn from global practices in the matured markets.

## Purchase Price Allocation under Ind AS 103, IFRS 3, ASC 805 – Business Combination

- As per current financial reporting framework, Purchase Price Allocation (“PPA”) is required for every business combination where the investor acquires control over the business/es:
 

*(As per Ind AS 110, the existence of control by an investor over an investment is identified where the investor have (a) power over the investee; (b) exposure, or rights, to variable returns from its involvement with the investee; and (c) the ability to use its power over the investee to affect the amount of the investor’s returns)*

  - Ind AS 103, IFRS 3, ASC 805 – Business Combination requires all business combination to be accounted and reported using acquisition method. Under acquisition method, the acquirer recognizes the assets acquired and liabilities assumed at their respective fair values as on the acquisition date
  - Ind AS 113, IFRS 13, ASC 820 – Fair Value Measurement provides guidance valuation of assets
- Ind AS 103 defines business combination as a transaction or other event in which an acquirer obtains control of one or more businesses. The assets acquired and liabilities assumed should constitute a business with input-process-output

relationship, i.e. an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants

- As part of applying the acquisition method, the acquirer shall recognize the consideration transferred for the acquiree; recognize and measure the identifiable assets acquired, liabilities assumed, and noncontrolling interest in the acquiree; and recognize and measure goodwill (or gain in a bargain purchase transaction)

### Approach for Purchase Price Allocation

- Purchase Price Allocation refers to the allocation of the purchase consideration paid by the acquirer for the assets acquired and liabilities assumed as a part of transaction
  - Purchase Consideration represents the total purchase price or consideration paid as part of the transaction and includes upfront payments, earnouts and other contingent payments and deferred payments not linked to any employment conditions of the promoters (if the promoters continue post transaction)
  - Purchase Consideration is first allocated to acquired tangible assets and identified intangible assets
  - Balance consideration (i.e. purchase consideration paid over and above the value of assets of tangible assets and identified intangible assets) is assumed to be paid towards Goodwill
  - In cases where the sale is under desperate or stressed situation by the seller, the value of assets acquired may exceed the purchase consideration paid resulting in a bargain purchase

Purchase Consideration (Total Price paid for the acquisition) consist of 3 major components as listed below:



**Value of Tangible Assets** acquired as a part of the transaction are considered at Fair Value.

It Includes Fixed Assets, Net Working Capital, Cash and Bank Balances and Other assets not forming part of working capital.

**An Intangible Asset** is an identifiable non-monetary asset without physical substance. It includes the following broad categories:

- Customer related intangible assets
- Distributor related intangible assets
- Technology related intangible assets
- Marketing related intangible assets (like brand, tradename, distribution network, etc)
- Contract related intangible assets
- Other intangible assets

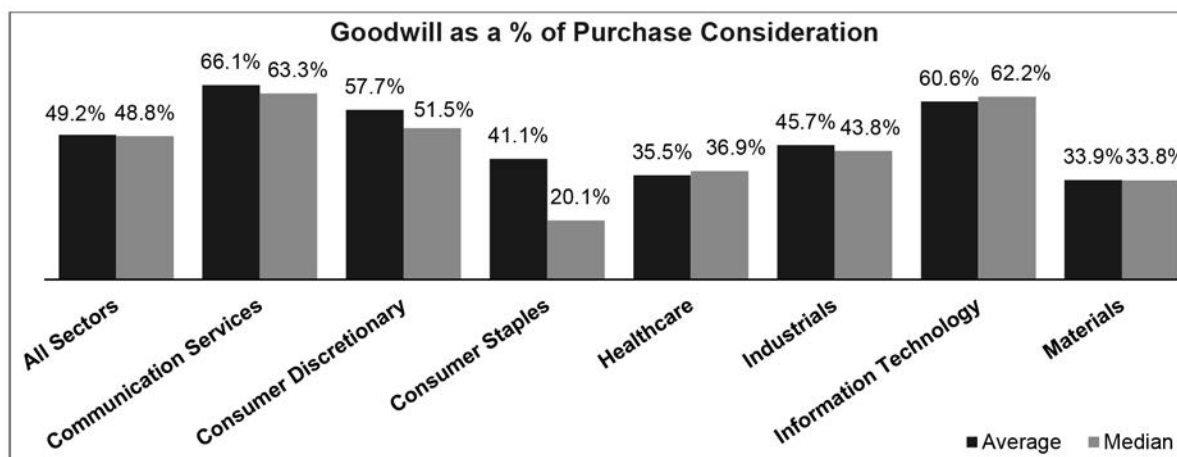
**Goodwill** relates to an asset representing the future economic benefits arising from a business, business interest or a group of assets, which has not been separately recognized in other assets.

Purchase Consideration	xxx
Less: Value of acquired tangible assets	(xxx)
Less: Value of acquired identified Intangible Assets	(xxx)
<b>Goodwill</b>	<u>xxx</u>

## Insights from study of PPA from past transactions

Analysis of PPA recorded in past transactions could provide a good guidance on the key value drivers in different businesses. In the absence of any readily available studies on past Indian transactions in public domain in our understanding, we have presented inputs from internal analysis carried out by Unithos Business Advisors Private Limited (referred to herein as “Unithos”) relating to domestic, inbound and outbound M&A transactions between FY2017 and FY2019. As part of this study, Unithos has analysed and shortlisted over 200 transactions wherein PPA is applicable and information is disclosed in the annual reports of the acquirers.

Overall Goodwill constitutes around 48.8 per cent (mean) to 49.2 per cent (median) of the purchase consideration across all industries during the period FY17 to FY19. This relates to the price paid by the acquirer for the future economic benefits arising from a business, business interest or a group of assets, which has not been separately recognized in other assets. This varies across sectors and normally the asset heavy businesses like manufacturing, healthcare where the underlying value creation is based on the physical assets, capacity and identified technology would record lower goodwill compared with service organizations who derive significant value from assembled workforce and higher valuations for future possible growth opportunities.



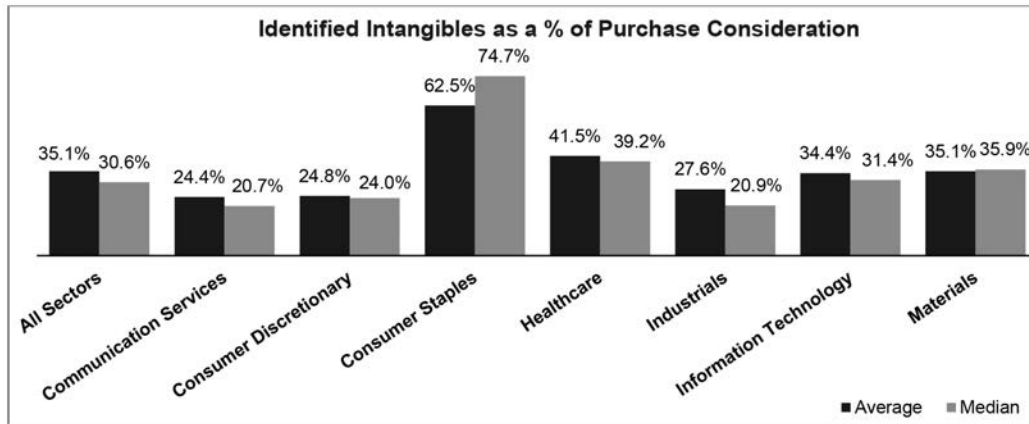
Sources: Secondary Research, Annual Reports, Venture Intelligence & Unithos Analysis

### Note:

1. Sector Classification is based on General Industry Classification Standards (GICS)
2. Bargain purchase transactions are not considered in the charts presented in this note

In our sample analysis, around 12 per cent of the transactions recorded bargain purchase transactions where the fair value of assets acquired as part of the transaction is higher than the purchase consideration paid for such acquisition. We noted that Consumer Discretionary sector recorded the maximum number of bargain purchase transactions across sectors and Information Technology and Utilities sector the least. Such transactions are not considered in the charts presented in this note.

Overall identified intangible assets constitutes around 30.6 to 35.1 per cent of the total purchase consideration in M&A transactions across all industries during the period FY17 - FY19. This proportion varies across industries based on factors like nature of industry, business operational model, regulatory framework, level of competition, etc. within different sectors. Transactions in select industries within the Consumer Staples sector like Household and Personal Products comprises significantly higher proportion of intangibles (mean and median of 62.5 per cent to 74.7 per cent) as compared to Communication Services and Industrials sector with relatively lower proportion of intangibles (mean and median in the range of 20.7 per cent to 27.6 per cent).



Sources: Secondary Research, Annual Reports, Venture Intelligence & Unithos Analysis

**Note:** Sector Classification is based on General Industry Classification Standards (GICS)

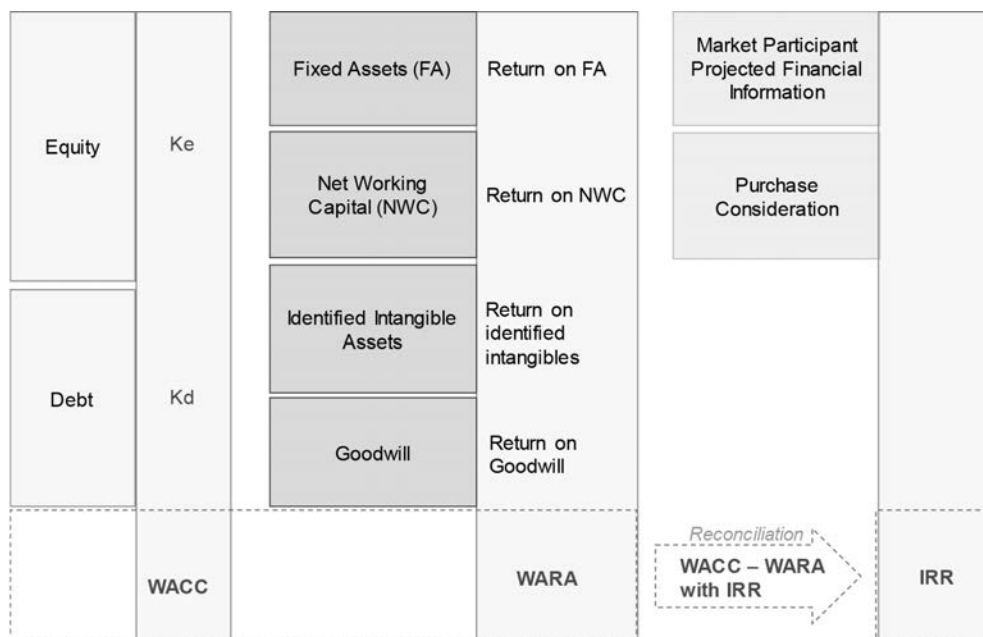
### Useful life of Identified Intangible Assets

- Life of intangibles are normally analysed considering technical, economic and contractual factors
  - Management may take a call to record intangibles at a shorter life based on internal accounting policies, internal strategies for continued use for economic benefits.
  - Intangibles like non-compete are governed by the contractual terms in the transaction document.
- Normally the main value drivers of the business would have long lives establishing the very rationale for acquisition
- The acquired Intangible assets are amortised over the useful life of the asset
- In certain cases, Market related Intangibles have indefinite useful life. In these cases, the Intangible assets are tested for impairment on annual basis or as and when it is required

### WACC – WARA reconciliation with IRR:

One of the key technical nuances of a purchase price allocation is to reconcile WACC-WARA with IRR:

- Weighted Average Cost of Capital (WACC) represents the rate of return required by the debt and equity stakeholders
- Weighted Average Return on Assets (WARA) represents the rate of return earned by the acquired assets
- Internal Rate of Return represents the rate of return in the transaction from the acquirer's perspective



- The interrelated nature of WACC and WARA, and its reconciliation with IRR is critical to the purchase price allocation and the failure to understand the relationship can lead to inaccurate discount rates
  - Contractual restrictions influencing life and valuation of intangibles
  - Assumptions relating to attrition rates of customers, vendors and employees
  - Use of the intangible (like brand, distribution network, IP, technology, etc.) from a market participant perspective
  - Valuation of non-compete involve subjective assessment of the ability and desirability of the sellers to compete post the transaction in the absence of non-compete clause in the agreement

#### **Other technical nuances:**

- Structure of the purchase consideration
  - Purchase consideration could be paid in lumpsum, can be deferred or contingent upon achievement of agreed criteria and/ or milestones with the seller(s)
  - Deferred consideration refers to amount agreed to be paid at a fixed date at a later point in time
  - Contingent consideration refers to amount to be determined and payable at a future date subject to achievement of agreed criteria/ milestones (such as achievement of future revenue, EBITDA, product release etc.)
- Assembled Workforce
  - Assembled workforce doesn't meet the definition of an identifiable intangible asset as it doesn't meet the contractual or separability criteria but acts as a contributing factor in generating cash flows of other identifiable intangible assets
- Impairment of intangibles
  - Intangible assets with finite lives are amortized and assets with indefinite useful lives and intangible assets not yet available for use need to be tested for impairment at least annually or between annual tests whenever there is an indication of impairment
- Taxation aspects (TAB)
  - The tax benefits due to the amortization of intangible assets enhances the value of the intangible assets by the amount of the present value of tax savings
- Book Goodwill – link to Deferred Tax Asset and Liability
  - For tax purposes the write-ups/downs of the tangible and intangible assets are treated differently than the accounting treatment and this leads to the creation of Deferred Tax Asset/Liability

#### **There is an increasing need for PPA analysis by various stakeholders of businesses:**

- For Corporate Governance - To justify the price paid for the business combination
- For Accounting requirement - To support fair value reporting in the books of the Acquirer
- For pre-deal Valuation - For understanding constituents for the proposed deal
- For Taxation purposes – For ascertaining the depreciation of Intangible Assets

#### **As an essence of the above analysis, PPA should normally reflect the acquirer's rationale for the transaction and involves subjective assumptions within the technical framework**

PPA exercise involves subjective analysis of a given business/transaction and requires a deeper understanding of requirements from accounting, tax and valuation perspectives hence reference to past transactions is relevant besides consulting relevant subject matter specialists.

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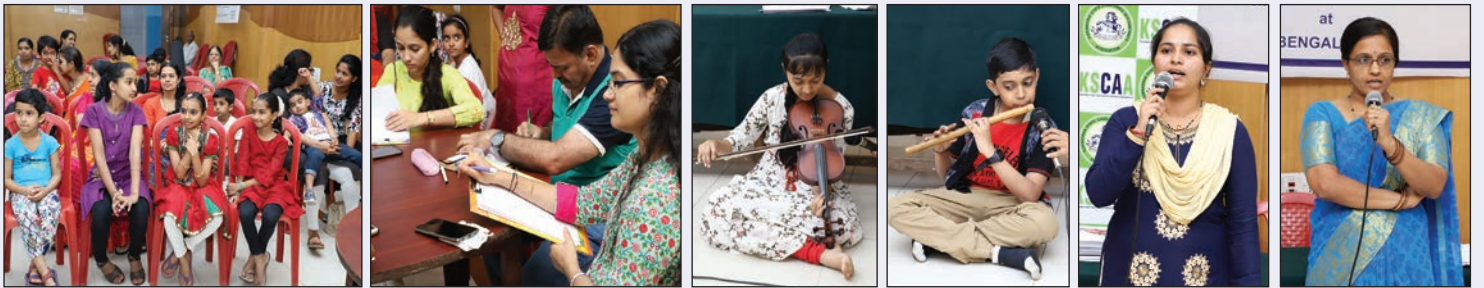
## KSCAA and FKCCI Joint Meeting with CA Sri Prafulla P Chhajed, President of The Institute of Chartered Accountants of India



## Sports & Talent Meet 2019 held on 10th November 2019



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# FINANCIAL REPORTING AND ASSURANCE

CA. Vinayak Pai V

## 1. CHANGES: *Monthly Roundup*<sup>1</sup>

Ind AS	<ul style="list-style-type: none"> <li>Exposure Draft               <ul style="list-style-type: none"> <li><b>Interest Rate Benchmark Reform</b> (Amendments to <b>Ind AS 109</b> and <b>Ind AS 107</b>).</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li><b>ITFG Clarification Bulletin No. 22</b> covering issues related to               <ul style="list-style-type: none"> <li>Ind AS 116, Ind AS 115, Ind AS 103 and Ind AS 1.</li> </ul> </li> <li><b>ITFG Clarification Bulletin No. 23</b> covering issues primarily related to certain accounting aspects emanating from the <b>Taxation Laws (Amendment) Ordinance 2019</b>.</li> </ul>
IFRS	<ul style="list-style-type: none"> <li><b>Compilation of Agenda Decisions – Volume 1</b> <ul style="list-style-type: none"> <li>Publication of the IFRS Interpretations Committee compiling all Agenda decisions published by IFRIC in the period January to September 2019.</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li>Proposed <b>Changes to IFRS Taxonomy 2019</b> for <i>Interest Rate Benchmark Reform</i>.</li> </ul>
Assurance	<ul style="list-style-type: none"> <li><b>IFAC Publications</b> <ul style="list-style-type: none"> <li>International Standards: <b>2019 Global Status Report</b>.</li> <li><b>A Guide For Professional Accountancy Organizations – Developing Good Practices for Members Providing Tax Advice</b>.</li> </ul> </li> </ul>
Company Law/ SEBI	<ul style="list-style-type: none"> <li>MCA General Circular No. 12/2019 dated October 24, 2019               <ul style="list-style-type: none"> <li>Relaxation of additional fees and <b>extension of last date of filing of CRA-4 (Cost Audit Report)</b> for FY 2018-19. Extended till December 31, 2019.</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li>MCA General Circular No. 13/2019 dated October 29, 2019               <ul style="list-style-type: none"> <li>Relaxation of additional fees and extension of last date in filing of forms <b>MGT-7 (Annual Return)</b> and <b>AOC-4 (Financial Statement)</b> for <b>FYE 31.03.2019</b> (e-forms AOC-4, AOC-4 (CFS), AOC-4-XBRL upto November 30,2019 and e-form MGT-7 upto December 31, 2019).</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li><b>Companies (Cost Records and Audit) Amendment Rules, 2019</b> – Notification dated October 15, 2019.</li> </ul>
	<ul style="list-style-type: none"> <li><b>Companies (Accounts) Amendment Rules, 2019</b>- Notification dated October 22, 2019               <ul style="list-style-type: none"> <li>Rule 8 (Matters To Be Included In The Board's Report).</li> </ul> </li> </ul>
	<ul style="list-style-type: none"> <li>SEBI Circulars               <ul style="list-style-type: none"> <li>Disclosure Of <b>Divergence In Asset Classification And Provisioning</b> By Banks.</li> <li>Framework For Listing Of Commercial Paper (<b>Disclosures Framework</b>).</li> <li><b>Resignation Of Statutory Auditors From Listed Entities And Their Material Subsidiaries</b>.</li> </ul> </li> </ul>
RBI Notifications	<ul style="list-style-type: none"> <li>Expanding and Deepening of <b>Digital Payments Ecosystem</b>.</li> </ul>
	<ul style="list-style-type: none"> <li>Revision in Proforma and Reporting of Bank/Branch details under <b>Central Information System for Banking Infrastructure</b>.</li> </ul>
	<ul style="list-style-type: none"> <li><b>Lending by Banks to InvITs</b>.</li> <li><b>Sovereign Gold Bond Scheme – Marking of Lien</b>.</li> </ul>
US GAAP	<ul style="list-style-type: none"> <li>The Financial Accounting Standards Board (FASB) has approved its August 2019 proposal to grant private companies and certain small public companies <b>effective date delays</b> on following standards:               <ul style="list-style-type: none"> <li><i>Current Expected Credit Losses (CECL)</i></li> <li><i>Leases</i></li> <li><i>Hedging</i>.</li> </ul> </li> </ul>

<sup>1</sup>Updates for the period Oct 1 to Oct 31, 2019

## 2. THE TAXATION LAWS (AMENDMENT) ORDINANCE, 2019: ITFG Clarifications

The ITFGs clarification on certain accounting aspects related to *The Taxation Laws (Amendment) Ordinance, 2019* is summarized herein below.

- The **lower tax rates** as per the Taxation Ordinance should be applied by a company for **measurement of current and deferred taxes** only if it **expects to opt** for the lower rates. If a company's intention to opt for lower tax rate is **appropriately evidenced**, lower tax rate as per the Ordinance should be given effect to while determining current and deferred tax assets/liabilities for the purposes of presenting interim results/interim financial statements for the quarter and half-year ended September 30, 2019.
- Adjustments resulting from **recognition of deferred tax assets/liabilities** directly in equity as per Ind AS 101 **at first-time adoption** and adjustments for tax effects directly in equity at the time of **initial application of Ind AS 115 and Ind AS 116**:

An entity should determine the nature of the underlying items with respect to which deferred taxes were recognized by it at the time of first-time adoption of Ind AS or at the time of initial application of Ind AS 115 or Ind AS 116. Accordingly, **depending on the nature of an item**, the **change** in the amount of the related deferred tax asset or deferred tax liability **resulting from the remeasurement** of the same at lower tax rates introduced by the Ordinance should be **recognized in profit or loss, or other comprehensive income or directly in equity** as required by Ind AS 12, *Income Taxes*.

## 3. GETTING UP TO SPEED: *New Insurance Contracts Standard* – IFRS

The IASB issued **IFRS 17, *Insurance Contracts*** in 2017 with an **effective date of January 1, 2021**. IFRS 17 replaces existing standard IFRS 4, *Insurance Contracts*.

The new insurance contracts standard sets out the requirements an entity is required to apply in reporting information about insurance contracts it issues and reinsurance contracts held.

An entity issuing an **insurance contract** is required to **initially measure** it at the sum total of a) the **fulfillment cash flows**, and b) the **contractual service margin** by assessing the rights and obligations arising from groups of contracts and reflects them net on the balance sheet on a discounted basis.

**Fulfillment cash flows** are the current estimates of expected amounts to be collected (premiums) and paid (claims, benefits, expenses), including an adjustment for the timing and risks of such amounts. These assumptions are to be updated at each reporting date. The subsequent accounting depends upon which estimates of the fulfillment cash flows are being updated. **Changes relating to current or past coverage** are **recognized in P&L** and **changes relating to future coverage** are recognized by way of **adjustment to the contractual service margin**.

**The contractual service margin** is the expected profit from providing the coverage to customers. The same is required to be **recognized in P&L over the coverage period**. Expected losses arising from **onerous contracts** are accounted **in P&L as soon as the losses are expected**.

IFRS 17 also requires comprehensive disclosures to enable users assess the risks the reporting entity faces from issuing insurance contracts.

The corresponding standard under Indian Accounting Standards (Ind AS) is awaited.

## 4. CASE STUDY: *Reporting On A Key Audit Matter (KAM)* – Corporate Transactions (Business Acquisitions)

### a) *Background*

During the period under report, the client completed two acquisitions resulting in it obtaining control of subsidiaries. The accounting for these acquisitions involves a number of key judgments specifically in respect of determining if each of the acquisitions is a business combination or an asset acquisition, calculating the purchase price allocation to the identifiable assets and liabilities of the business acquired, gain arising on revaluation of pre-existing stake and estimating the fair value of the contingent consideration.

b) *How The Audit Addressed the KAM*

- The auditors **challenged management’s assessment** of whether the acquisitions meet the **definition of a business** through assessment of the acquirer’s business activities, employees, other inputs, processes and outputs.
- The auditors **reviewed the purchase agreement** for each of the corporate transaction and **challenged management’s calculation** of the purchase price allocation, the relevant net present value models to support the valuation of an intangible asset recognized and the gains arising on revaluation of the group’s pre-existing interest in the acquired businesses.
- The auditors **evaluated the design and implementation of relevant controls** relating to the acquisition process.
- The auditors **evaluated the consistency of the key assumptions** used in the preparation of valuation reports with the assumptions used and assessed the competence, experience and objectivity of management’s experts.

5. **FIN ST EXTRACTS: Ind AS 116**

Extracts from published financial statements of a listed company related to Ind AS 116, *Leases* standard adoption.

- Ind AS 116, the new leases standard provides a **single lessee accounting model** for the recognition, measurement, presentation and disclosure of leases. The standard applies to all leases including subleases and requires lessees to recognize assets and liabilities for all leases, unless the lease term is 12 months or less, or the underlying asset has a low value. Lessors continue to classify leases as operating or finance. The principal impact of Ind AS 116 is the change of lessee’s accounting treatment for the contracts, which were previously classified as operating leases.
- The Group has elected to adopt the **modified retrospective transition** approach. The cumulative impact of transition is recognized in retained earnings with no restatement of the comparative period.
- On transition, lease liabilities were recognized as the **present value of the lease payments still to be made**, discounted at the appropriate incremental borrowing rate of x.xx% applicable at the date of initial application.
- For the majority of leased assets, the corresponding **right of use asset** was **recognized equal to the value of the lease liability** at the date of initial application, adjusted for any accrued or prepaid lease payments. Total right of use assets and respective lease liabilities, recognized at April 1, 2019 amount to Rs. xx. Crore and principally relate to the leased office buildings and other property.
- The Group has determined that **surface lease arrangements** for the purposes of mining and exploration activities fall out of the scope of Ind AS 116.

6. **BACK TO BASICS: Non Current Assets Held For Sale (Ind AS)**

The accounting guidance for **Non Current Assets Held For Sale** is contained in Ind AS 105, *Non Current Assets Held For Sale and Discontinued Operations*, the salient aspects of which are discussed herein below.

- Non-current assets and disposal groups classified as held for sale are **measured at the lower of their carrying amount and fair value less costs to sell**.
- Non-current assets and disposal groups are **classified** as held for sale **if their carrying amount will be recovered through a sale transaction** rather than through continuing use. The **condition** is regarded as met only when the sale is **highly probable** and the asset (or disposal group) **is available for immediate sale** in its present condition.
- Management must be **committed to the sale**, which should be expected to **qualify for recognition as a completed sale within one year** from the date of classification.
- When a group is committed to a **sale plan involving loss of control of a subsidiary**, all of the assets and liabilities of that subsidiary are classified as held for sale when the criteria described above are met, regardless of whether the Group will retain a non-controlling interest in its former subsidiary after the sale.

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## “MOOWR, 2019”- BREEZY WINGS FOR THE MANUFACTURING SECTOR?

**Adv. M.G. Kodandaram**

*IRS, Assistant Director (Retd), NACIN*

### **Introduction**

For the slogan ‘Make in India’ to be meaningful, it is essential to provide conducive atmosphere to the manufacturing sector so as to enhance their productivity and quality. Encouraging the manufacturing activity with timely investments and funds may not be sufficient to withstand the impact of accelerated Global trade and Commerce. But such manufacturing fraternities require support in other spheres, like availability of quality and economically priced raw materials, reduction in interference by various statutory agencies, removal of trade barriers across nation, simplified procedures etc., and such backing should come from the reforms initiated by the governments. The goods so manufactured should be able to meet the requirements of international standards, so that they can compete with the imports made from the international markets. Further, unless we export goods and services, we cannot graduate ourselves into a developed economy. I keep saying again and again, that the Import of goods and services amounts to export of foreign currency, whereas the export of goods and services mean import of foreign currency into the country, which in turn strengthens our economy.

### **Exports to strengthen the Economy**

To enable export of our products to other countries, such goods manufactured should get endorsement, recognition and goodwill from the consumers of such destination countries. The goods so manufactured should be as per the requirements of the international standards and applications, both in terms of quality and price. The dynamic changes that are taking place in technology have resulted in availability of more alternatives to the consumer. Added to the dynamic product preferences by the present day consumers, the e-commerce players have created virtual platforms for faster trade across the globe. To meet the requirements of such an accelerated market, all barriers in the domestic market environment are to be minimized, if not eliminated. The investment support should always be easily accessible to all manufacturers. Such a requirement is more in respect of enterprises in MSME sector, as for this sector, sources for funds are difficult to

obtain. As per the available data for the year 2017-18, out of the value of exports of goods of USD 147,390.08 million, the contribution by MSME sector is 48.56%. Further this sector provides employment to around 100 million people and livelihood to over 100 million families. Therefore our foremost obligation should be to extend all possible assistance to protect and preserve the existence of MSME sector. Added to the investments, the latest technology and the raw-materials should be easily available to all such entities at short notice. Then alone we can withstand and grow to meet the challenges of international trade.

### **Warehousing provisions under Customs Act**

The Customs act 1962 [hereinafter Customs act], from the beginning has supported the manufacturing industry by providing legal framework in the form of ware housing provisions. The chapter IX of the said act [from Section 57 to 73A] has provisions relating to bonded warehouse facilities, by use of which the importer of certain category of imported goods are allowed to deposit such goods, without payment of duty / tax. The types of warehouse licences permitted included a public ware house as per Section 57, a private ware house as per Section 58 or a special ware house as per Section 58A of the said act. The law empowers the Principal Commissioner/ Commissioner of Customs [hereinafter, commissioner, for brevity], subject to such conditions as may be prescribed, licence a public, private or special warehouse wherein the dutiable goods are allowed to be deposited without payment of custom duty and GST. Such warehouse shall be caused to be locked by the proper officer and no person shall enter the warehouse or remove any goods from that premises, without the permission of the proper officer.

For the purposes of availing the warehousing facility, the importer, on import of goods, has to file an into-bill of entry. He is allowed to store such goods in the bonded / licensed premises for limited time. Before expiry of the stipulated time, the importer has to file an ex-bond bill of entry, make necessary payment of duty / taxes and clear the goods for home consumption. In case these goods are to be removed for export, the tax liability on such imported raw

materials used in such exported goods, would stand waived. For the intervening period, the user has to incur expenses in the form of interest to the authorities and as warehousing charges to the license holder of the warehouse.

### Formation of EOUs and SEZs

Later this concept was expanded, to enable importer to license his own manufacturing premises as a private bonded warehouse, so that he need not keep goods in public warehouse. This provision allowed such persons the liberty to engage in manufacturing activity in their premises, thereby reduced the cost involved in warehousing and other carrying costs connected with such an activity. This facility was extended subject to condition that all such goods so manufactured are exported out of India, within a time frame. This gave birth to formation of export oriented units(EOU), Software Technology parks(STP) electronic hardware technology park(EHTP), biological technological park(BTP) The other important condition was that these units were under physical control of the Customs department. As stipulated under Section 65 of the act, the EOUs are allowed manufacturing of new products using the imported goods, in the warehouse itself.

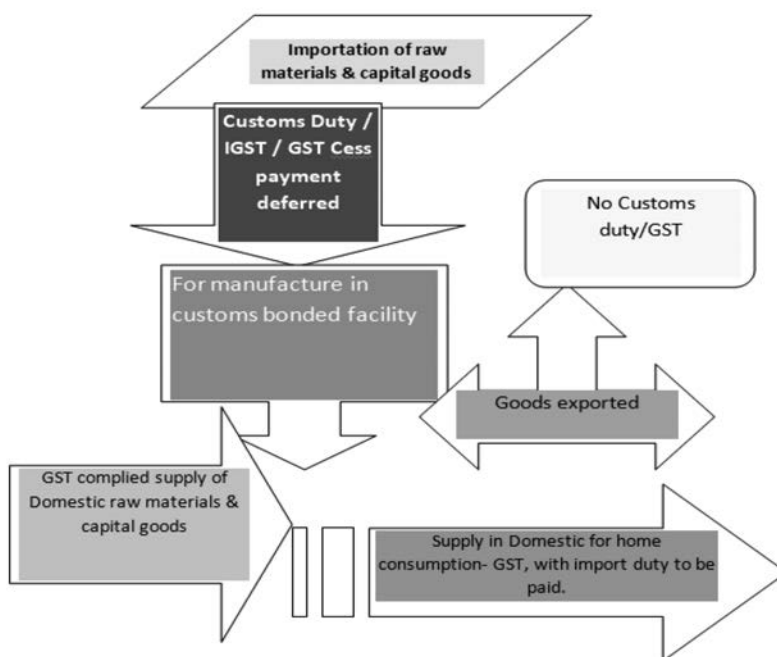
After the liberalization, the concept of having notified SEZ area as per SEZ Act 2005 was conceived so as to orient the manufacturing sector towards manufacture of goods exclusively for export. By adopting this scheme, both the SEZ developer as well as the Units in the notified SEZ area could get requirement of all raw materials and capital goods without payment of duty / tax. The enterprise desiring to draw benefits under the SEZ Act has to hire premises in the approved SEZ area and all goods so manufactured shall be exported. As the procedures and conditions are very stringent, like requirement of owning premises in SEZ area etc., the manufacturing sector continued to suffer. The barriers instead of reducing, multiplied and this lead to stunt the growth of the manufacturing sector.

### The new warehousing scheme - MOOWR, 2019

To compete in the international market, an open-ended scheme, with least conditions and simple procedure is of paramount importance. These principles have been built into the present scheme, named as ‘Manufacture and Other Operations in Warehouse (no. 2) Regulations, 2019’ [MOOWR, 2019, for short], the author feels. The Customs Department and the CBIC have launched the above

revamped scheme to boost the manufacturing activity in the country. For rolling out the new scheme, the existing provisions for manufacturing goods in a custom bonded warehouse have been further relaxed. As per these revised regulations, the importers can import both raw materials and capital goods, carry out the manufacturing activity at the Customs bonded warehouse, for which period the payment of import duty as well as IGST and GST Cess will be deferred. Such manufactured goods will be free from payment of any kind of duty or interest if they are exported. This is going to improve the liquidity of the companies and make Indian exports, price competitive in the international market. Also there is no bar or restriction in clearing these goods for home consumption on payment of appropriate duty /tax. There is no interest charged for the intervening period. There are further changes desirable by all stake holders, which are discussed at the end of this article. Before understanding the new scheme let us have a look at the short coming in the domestic business and manufacturing environment.

The “MOOWR, 2019” could be pictorially depicted as follows:



### Shortcomings in the domestic manufacturing environment

The Indian export trade has always suffered due to continuation of the policies set out by the British. The domestic manufactures and trade were always the victims of multitude of authorities, designated for regulating

and monitoring the compliance with each set of law and procedure. There was no serious thought given to reduce the barriers in manufacturing as well as trading sectors within the domestic market. The development of the economy had remained a mere slogan. Added to this, the onslaught of globalization caused more injury and many manufacturing industries were forced to close down, as their products became outdated and irrelevant in the changing world trade. However, the liberalization and brining out of VAT in 2005 brought little relief. But the country's markets remained divided, with legal barriers in movement of goods, services and facilitation to manufacturers and trade.

The advent of Goods and Services Tax (GST) from 1.7.2017 did bring some relief to the sad state of Indian manufacturing industry. The GST, the single major tax reform undertaken since Independence, is aimed at ease of doing business. We are steadily moving towards a uniform, self-regulating and transparent GST regime. Introduction of seamless credit system unified the domestic market. 'One country, one law, one rate, one market and one national e-way bill' removed much of the barriers in the domestic business. The uniform law and procedure and the common compliance mechanism by use of single port in the form of GST Network helped the manufacturing sector to flourish. The GST council, being the central decision making body, added more wings to the formation of harmonious environment to all businesses and manufacturers.

In GST regime Exports are considered as zero-rated supply. No tax is payable on export of goods or services and also credit of the input tax related to the supply of inputs, input services and capital goods, shall be admissible as credit to exporters or can be claimed as refund by them. The efficient neutralization of taxes especially for exports made our products more competitive in the international market, gave boost to Indian Exports. This resulted in overall improvement of investment climate in the country. The GST is an important and revolutionary move towards rebuilding this great country, into an economically and socially strong Nation.

However the imposition of Basic Customs duty, other Customs levies, integrated tax and composition cess at the time of imports, increased the cost of the products as such expenses are to be borne till the goods and services are exported. The delayed disposal of refund claims related to exports became a night mare to the industry and trade. The MSMEs could not bear such costs and their performance reached all time low. This had a very bad impact on Indian

economy and a solution to overcome this precarious situation required immediate attention. Many measures on priority are taken by the Government towards improving the business environment. One of such measure taken is Manufacture and Other Operations in Warehouse scheme, with least procedural hurdles by Customs, wherein enterprises – manufacturers as well as traders - are freed from the burden of additional cost, during import, in respect of taxes cited above. The persons adopting the said scheme are allowed to pay Customs duties and other taxes on a deferred date, at the time of removal from the approved bonded warehouse. Now let us discuss the scheme in detail in further part of this article, so that every manufacturer who depends on imported Raw materials and capital goods uses the said scheme to their advantage, thereby make in India becomes a reality.

#### **Legal framework of “MOOWR, 2019” scheme**

The CBIC 1962 has re-jigged the existing warehousing provisions Section 65 of the Customs Act, by issue of notification 69/2019-Customs (N.T.) dated 1<sup>st</sup> October, 2019. These regulations are called as 'Manufacture and Other Operations in Warehouse (no. 2) Regulations, 2019' or for short, as “MOOWR, 2019” scheme.

The regulation 4 of the above scheme stipulates the eligibility criteria for making an application for operating under the said regulations as follows : (i) a person who has been granted a licence for a warehouse under Section 58 of the Act, in accordance with Private Warehouse Licensing Regulations, 2016; (ii) a person who applies for a licence for a warehouse under Section 58 of the Act, along with permission for undertaking manufacturing or other operations in the warehouse under Section 65 of the Act. It is to be noted that an applicant desirous of having manufacturing operations in a bonded warehouse under Section 65 read with MOOWR, 2019 must also have the premises licensed as a private bonded warehouse under Section 58 of the Customs Act. Now by virtue of this regulation, the applicant can seek a license under Section 58 and permission to operate under Section 65 synchronously, or request for permission under Section 65, if they already have a warehouse licensed under Section 58.

For operating under the regulations, an application shall be made to the Commissioner of Customs, along with an undertaking (i) to maintain accounts of receipt and removal of goods in the specified digital format and furnish the same to the bond officer on monthly basis digitally; (ii) to execute a bond in specified format; and (iii) to inform



the input-output norms, for raw materials and the final products and to inform the revised input-output norms in case of change therein. For the purposes of uniformity, ease of doing business and exercising due diligence, for grant of permission, the form Annexure A has been prescribed. It must be noted that the form of application has been so designed that the process for seeking grant of license as a private bonded warehouse as well as permission to carry out manufacturing or other operations stands integrated into a single form. The declaration to be made to satisfy regulation 5 of Private Warehouse Licensing regulations 2016 and the undertaking to be made by the applicant as per regulation 4 of MOOWR 2019 are included in the application format as Part II.

The Central Board of Indirect Taxes and Customs (CBIC) in coordination with Invest India under the Department for Promotion of Industry and Internal Trade (DPIIT), Ministry of Commerce and Industry, has launched a microsite for the promotion of this scheme. The online facility can be accessed at <https://www.investindia.gov.in/bonded-manufacturing>. The facility hosts a digitized application that an applicant can fill online, upload the supporting documents, submit online and also print the application form.

### **Granting of permission**

On verification of the request so made, the proper officer of Customs shall grant permission to operate under the regulations 5. As per Regulation 3 (2) (e) (i) of the Private Warehouse Licensing Regulations, 2016, the Commissioner has to be satisfied that the site or building of the proposed private warehouse is suitable for secured storage of dutiable goods. Regulation 8 of MOOWR 2019 requires the licensee to provide such facilities, equipment and personnel as are sufficient to control access to the warehouse, provide secure storage of the goods and ensure compliance to the regulations. The physical verification is mandated so that a unit fully closed or fictitious or benami or a shell company doesn't misuse the benefits of the scheme. The warehouse in which Section 65 permission is granted shall also be declared by as the principal or additional place of business, as the case may be, for the purposes of GST.

The permission so granted, shall remain valid [refer regulation 6] unless it is cancelled or surrendered, or the license issued under Section 58 is cancelled or surrendered, in terms of the provisions of the Act. A person, who has been granted permission as above, shall appoint a warehouse keeper with sufficient experience in warehousing

operations and Customs procedures to discharge functions on his behalf. The warehouse keeper shall obtain a digital signature from authorities licensed by the Controller of Certifying Authorities for filing electronic documents required under the Act. [Refer Regulation 7]. Such a person shall provide at the warehouse, (i) signage that prominently indicating that the unit is a Customs bonded warehouse; (ii) a computerized system for accounting of receipt, storage, operations and removal of goods; and (iii) such facilities, equipment and personnel as are sufficient to control access to the warehouse, provide secure storage of the goods in it and ensure compliance to these regulations by officers of Customs. [Refer Regulation 8].

### **Transportation of imported goods from customs station**

The Regulation 9 mandates the conditions for transportation of imported goods, from the Customs station to a warehouse or from one warehouse to another warehouse or from the warehouse to a Customs station for export. In all such situations the load compartment of the means of transport shall be securely sealed with a one-time-lock [OTL].

When the goods are removed from the Customs station of import station to a licensed warehouse, the OTL shall be affixed by the proper officer of Customs. Later whenever the warehoused goods are removed from one warehouse to another warehouse, the OTL shall be affixed by the licensee. Also where such warehoused goods are removed to a Customs station for export, the OTL shall be affixed by the licensee. Having regards to the nature of goods or the manner of transport, the Commissioner has powers to permit transport of such goods without affixing the OTL. The licensees who wish to avail self-sealing facility for exports can avail the facility made available under circular 26/2017 Customs dated 01.07.2017 as modified from time to time.

### **Recording of goods receipt at the warehouse**

On receipt of goods at the warehouse, the licensee shall verify and record the details available on the OTL affixed by the proper officer. He may allow unloading, provided the OTL is found intact. He should verify the quantity of goods received by reconciling with the bill of entry for warehousing and endorse the said document accordingly. He should also acknowledge the receipt of the goods by endorsing the transportation document presented by the carrier of the goods. In both the instances retaining a copy of the said documents are essential. He should take these details into goods inward records maintained by him. Upon taking into record of the warehouse, the licensee shall

deliver an acknowledgement to the proper officer referred in Section 60 (1) and to the bond officer regarding the receipt of the goods in the warehouse.

In instances where the OTL is found not intact, he has to inform the bond officer [an officer of Customs in charge of a warehouse] immediately and should refuse the unloading of such goods. The officer concerned will initiate further actions as prescribed under Customs act. Any other discrepancy is noticed by the licensee, he should report the same within twenty-four hours to the bond officer. For more details refer regulation 10. The Board, having regard to the nature of the goods, their manner of transport or storage, may exempt a class of goods from any of the provisions of these regulations [Regulation 20].

Similarly on receipt of goods from another warehouse, the licensee shall verify the OTL affixed and inform the bond officer immediately, if the OTL is not found intact and also refuse the unloading of the goods. If the OTL is intact he may permit for the unloading, of goods received by reconciling with, forms under Section 65. All other procedure stated in the Para above shall be followed.

#### **Transfer of goods from a warehouse for export**

A licensee shall be allowed to transfer the warehoused goods to another warehouse or to a Customs station for export, with due intimation to the bond officer on the Form for transfer of goods from a warehouse after following procedure in regulation 13. On such intimation to the bond officer, the licensee shall, (i) allow removal of the goods and their loading onto the means of transport; (ii) affix a OTL to the means of transport; (iii) endorse the number of the OTL on the Form and retain a copy; (iv) endorse the number of the OTL on the transport document and retain a copy; (v) take into record the removal of the goods; and (vi) cause to be delivered, copies of the retained documents to the bond officer.

In case of goods removed for export, the licensee shall remove the resultant goods from the warehouse for export, upon, (i) filing a shipping bill or a bill of export; and (ii) affixing a OTL to the means of transport in which such goods are removed [regulation 15]. In all situations the licensee shall take into record the goods removed. To the extent that the resultant product manufactured or worked upon in a bonded warehouse is exported, the licensee shall have to file a shipping bill and pay any amounts due. A GST invoice shall also be issued for such removal. In such a case, no duty is required to be paid in respect of the imported goods contained in the resultant product as per the provisions of Section 69 of the Act.

#### **Removal of finished goods for home consumption**

As per regulation 14, a licensee may remove the resultant goods from warehouse for home consumption also subject to certain conditions which are more important to be followed: (i) A bill of entry for home consumption has been filed in respect of the warehoused goods contained in so much of the resultant goods and the import duty, interest, fine and penalties payable, if any, in respect of such goods have been paid; (ii) He shall retain a copy of the bill of entry filed and take into record the goods removed.

Since the warehouse operating under Section 65 also functions as a warehouse licensed under Section 58, the licensees can also import goods and clear them as such, for home consumption under Section 68 on payment of import duties, along with interest as per Section 61 (2) of the Act or clear them as such for export under Section 69 of the Act.

To the extent that the resultant product (whether emerging out of manufacturing or other operations in the warehouse) is cleared for domestic consumption, such a transaction squarely falls within the ambit of “supply” under Section 7 of the Central Goods and Service Tax Act, 2017. It would therefore be taxable in terms of Section 9 of the CGST Act, 2017 or Section 5 of the IGST Act, 2017 depending upon the supply being intra-state or inter-state. The resultant product will thus be supplied from the warehouse to the domestic tariff area under the cover of GST invoice on the payment of appropriate GST and compensation cess. As regards the import duties payable on the imported goods contained in so much of the resultant products are concerned, the same shall be paid at the time of supply of the resultant product from the warehouse for which the licensee should have to file an ex-bond Bill of entry and such transactions should be duly reflected in the accounts prescribed as form Annexure B. As per MOOWR, 2019, the applicant shall also inform the input-output norms, wherever considered necessary, for raw materials and final products and shall also inform the revised input-output norms in case of change therein.

#### **Maintenance of records**

In relation to warehoused goods as per regulation 17, a licensee shall, (i) maintain detailed records of the receipt, handling, storing, and removal of any goods into or from the warehouse, and produce the same to the bond officer, as and when required; (ii) keep a record of each activity, operation or action taken in relation to the warehoused goods; (iii) keep a record of drawal of samples from the warehoused goods under the Act or any other law for the time being in force; and (iv) keep copies of the bills of entry,

transport documents, Forms for transfer of goods from a warehouse, shipping bills or bills of export or any other documents evidencing the receipt or removal of goods into or from the warehouse and copies of the bonds executed under Section 59.

Such records shall be kept updated and accurate and preserved for a minimum period of five years from the date of removal of goods from the warehouse and shall be made available for inspection by the bond officer or any other officer authorised under the Act. He shall also preserve updated digital copies of the records above records at a place other than the warehouse to prevent loss of records due to natural calamities, fire, theft, skilful pilferage or computer malfunction. The licensee shall file with the bond officer a monthly return of the receipt, storage, operations and removal of the goods in the warehouse, within ten days after the close of the month to which such return relates.

For recording the manufacturing or carrying out other operations in a bonded warehouse, form Annexure B has been prescribed. Regulation 4 of the MOOWR, 2019, provides that the applicant under Section 65 shall undertake to execute a bond in such format as specified. Further, Section 59 of the Customs Act requires the owner of the warehoused goods to execute a triple duty bond for the warehoused goods. Thus, the bond prescribed under as per Annexure C should be used for meeting the requirements of both MOOWR, 2019 and Section 59 of the Customs Act.

The other records to be produced and Conditions to be followed by the licensee on due arrivals of goods are follows: (i) Filing of an acknowledgement for having deposited in the warehouse to the proper officer within one month; (ii) filing of acknowledgement to the bond officer, within one month from the date of removal of the goods from the warehouse; (iii) to the bond officer in charge of the warehouse, within one month from the date of removal of the goods from the warehouse, an acknowledgement issued by the proper officer at the Customs station of export, stating that the goods have arrived at that place. If there is any failure in following the above mandatory provisions, the owner of such goods shall pay the full amount of duty chargeable on account of such goods together with interest, fine and penalties payable under Section 72(1) of Customs act. If a person contravenes any of the provisions of these regulations, or abets such contravention or fails to comply with any of the provision of these regulations, he shall be liable to a penalty in accordance with the provisions of the Customs Act. The waste generated during the course

of manufacture of the resultant product may be cleared for home consumption in terms of Section 65(2) (a).

### **Treatment of exempted goods**

The imported goods even if either exempted or nil rated goods, can be procured and brought into the Section 65 bonded warehouse, as the objective of the scheme is to enable manufacture and other operations in the warehouses. For this purpose, the units are permitted to procure raw materials, consumables, capital goods etc., either through imports or through domestic market. However such procurements shall not be considered as warehoused goods in terms of Section 60 of the Act. This aspect has been clarified by issue of circular No. 34/2019-Customs [F. No: 473/03/2015-LC (pt.)] dated 1st October 2019.

In respect of domestic procurements, applicable rates of taxes shall be payable. The exemptions, if any, can also be availed by manufacturers under this scheme. Please note that a unit operating under Section 65, shall not be entitled to procure goods domestically, without payment of taxes. The records in respect of such domestically procured goods shall be indicated in the form for accounts. (Annexure B).

### **Advantages of “MOOWR, 2019” scheme**

The present Scheme is expected to ease the situation for the manufacturing sector as the manufacturing and processing activity in a Customs Bonded Facility, is without payment of duties / taxes upfront, on imported goods - both raw materials and capital goods. The advantages, as compared to the earlier warehouse provisions or EOU schemes or SEZ units are much more, and this should motivate the manufacturers to use the scheme on priority.

The highlights /advantages of this scheme in a nutshell are as follows:

1. Deferred duty on imported capital goods and raw materials – Normally basic Customs duty as well as IGST and GST Cess are payable before clearance of such goods from Customs station. In the present warehousing scheme, on imports of goods, the duty on such goods used in manufacturing or other operations are deferred until their clearance from the bonded facility. Literally this means that the Customs frontier gets extended to the bonded premises and upto the time of clearance of goods from such authorized warehouses. If such Capital goods can be sold to foreign manufacturers after utilization, then such duty deferred also could be avoided. The deferred duty on raw materials used is also waived in case finished the manufactured goods are exported. This will help retention of working capital by such licensed entities.

2. Seamless warehouse to warehouse transfer - Transfer goods from the bonded facility to another facility without payment of duty is allowed subject to certain conditions and procedures being followed as a self-managed procedure.

3. No fixed ratio for meeting the export obligation - There are no limit on the share of clearance of finished goods for the domestic market. An entity may manufacture in a bonded facility and sell up to 100% of the output in the domestic market also. Such a liberty is not available to export oriented units (EOU) as well as units situated in SEZ areas. If the EOU do not meet the requirement of NFE positive, they will be deprived of benefits under EOU scheme.

4. Domestic supplier also can avail the scheme - All entities engaged in the manufacture or trading of goods for supply into the domestic market or for export are also eligible for the benefits of obtaining a license under Section 58 and in-bond manufacture under Section 65 of the Customs Act, 1962. In these provisions, every manufacturer can utilize the said scheme to come out initial fund requirements for import and could pay Customs duty and GST before removal from Customs bonded premises.

5. Single point of approval - Commissioner of Customs acts as the single point of contact for all approvals for both licensing of warehouse license and manufacturing activities. Earlier the provisions required approval by different authorities. The EOU scheme as well as SEZ units have to follow administration by multitude of agencies for permission, license, certification etc. further the goods so manufacture are to meet the requirement of export markets only. In case of any supply to the domestic market attracts demand of differential duty foregone with penalty, interest and permission in each instance. There will be a single application-cum-approval form and a single digital account. And the concerned Commissioner of Customs will be the single point for granting approval and oversee the operations of such units.

6. Use Common form and forum - the Common application cum approval form for a license for private bonded facility and permission for manufacturing and other operations has eased the procedure of earlier provision. Such applications and related queries and correspondences are conducted through the digital means. Also a common authority will be handling all such related matters.

7. No geographical restrictions - New manufacturing facility can be set up or an existing facility can be converted into a

bonded manufacturing facility irrespective of its location in India. Earlier it required issue of a notification by Board or commissioner, the place as a Customs area where such a facility could be extended.

8. limitation of time are not applicable for storing and manufacture - Another notable feature in this new warehouse regime is that, unlike the earlier provisions, the limitation of time are not applicable for storing and manufacture or for export of goods. The licensing conditions covered under Section 61 of Customs Act, 1962, states that the warehousing period for goods in case of a warehouse wherein manufacture or other operations have been permitted under Section 65, would be upto their consumption (for inputs) or clearance from the warehouse (for inputs and capital goods).

9. Movements of bonded goods for jobwork allowed - The capital goods imported under bond could be sent for repair/ testing. The warehoused goods can be sent for job work and brought back to the Section 65 premises without payment of duty/tax. However, there is no provision for use of these goods for manufactured in the different premises. For conducting various activities / operations in the bonded warehouse premises and movements thereon, there is no requirement of obtaining prior permission of the proper officer.

10. Easy compliance mechanism - Maintenance of all records of manufacturing and other operations digitally in a single format as per Annexure B is prescribed. The earlier schemes were regulated and supervised physically by the Customs authorities on all situations. Now it is on self-management scheme we can say. The scheme would also enable efficient capacity utilization as there is no limit on the quantum of clearances that can be exported or cleared for the domestic market. Adoption of this scheme will improve the ease of doing business as it will bring down the cost of goods and make them competitive in the market.

11. Availability of other incentives under of Foreign Trade Policy - The goods manufactured and exported from Section 65 licensed premises are eligible for export benefits under Foreign trade policy or Customs (Import of Goods at Concessional Rate of Duty for Manufacture of Excisable Goods) Rules, 2017 [IGCR] depending upon the other conditions in the respective schemes.

12. No compulsory regular audit prescribed - In respect of Units under these provisions frequency for audit is not fixed. As done in other instances, the audit issues are covered

under Customs Audit Regulations, 2018 [Notification No. 45/2018-Cus (N.T.) dated 24/05/ 2018]. As per the latest instructions, the audit of units would be based on risk parameters and it could be in the form of post clearance audit [PCA] or Premises based audit (PBA).

### Types of Beneficiaries

All types of businesses can use the bonded manufacturing facility, avail exemption on Customs duty on imported inputs used in the production of finished goods to be exported. In the case of domestic consumption, the duty on imported inputs is deferred until the finished goods are cleared to the domestic market.

To understand these provisions better, Let us consider an example of a MSME industry, engaged in manufacturing of 'diamond industrial tools' to meet the requirement of domestic as well as export market needs. Under the scheme they are eligible to file an application for licensing a facility in their present manufacturing premises itself. They are allowed to import the required raw materials and capital goods for production of 'diamond industrial tools'. The duties on such imports are deferred, which provides additional working capital support to the manufacturer. Let us presume that the manufacturer exports 50% of the total produced tools and on such exports the deferred duty on that portion are waived. However the deferred Custom Duty and IGST are to be paid on the remaining 50% of such tools at the time of supply in the domestic market. By adopting this scheme the manufacturer is benefited by the deferred duty on imported inputs and capital goods and from reduced production cost due to such duty-free imports. Please note that there is no limitation of time to complete the activity. Also no interests are chargeable for the period of duty/tax that is foregone or deferred. Similar facilities are extendable to e-commerce operators, and merchant trade exporters, who can import goods, store, repack or re-brand and export to other country, taking relief under the scheme.

### The way ahead

The liberal approach under the hosted scheme may face hurdles as the officers of the departments concerned are not fully equipped to the changed circumstances of the law. As could be found from the website cited above, the stake holders, in addition to members of manufacture sector, trade and commerce consists of officers of CBIC, GST Commissionerates and state tax departments. Majority of these officers have not dealt with the Customs provisions and now they are to be enabled to learn about customs formalities and procedures, which is a challenging task. But there is no measure taken up by the authorities so far in this direction.

The other weak factor is that no publicity has been given to this scheme which has critical elements to strengthen MSME sector. Therefore, an early effort needs to be initiated to guide the manufacture sector as well as merchant export sector on this latest facilitation measure. In this regard, the roles of tax practitioners are equally important. The fraternities of chartered accountants need to spread the benefits of the scheme so that it is adopted by all eligible enterprises / persons. This will help in 'make in India', an achievable goal.

### The above article is based on the following resources

1. Customs act 1962 - Chapter IX - Warehousing provisions Sn.57 to 73A
2. Notification 69/2019-Customs (N.T.) dated the 1st October, 2019- Manufacture and Other Operations in Warehouse (no. 2) Regulations, 2019.
3. Circular No. 34/2019-Customs [F. No: 473/03/2015-LC(pt.)] dated 1st October 2019.
4. <https://www.investindia.gov.in/bonded-manufacturing>
6. <http://www.cbic.gov.in/htdocs-cbec/customs>

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We deeply regret to inform sad demise of  
**CA. O V Gadag,**  
a senior member of the fraternity;  
Past Chairman of Belagavi and  
Hubli Branch of SIRC of ICAI.  
*May his soul rest in peace.*

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