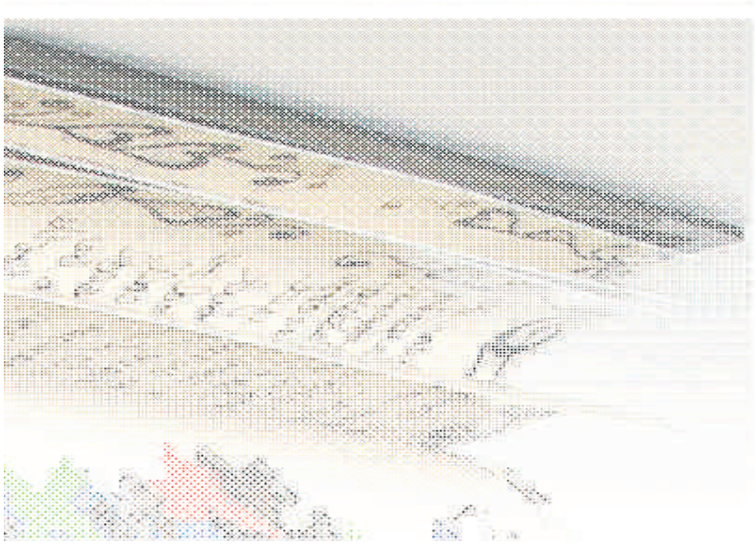
Volume-7 September -2016 Pages 1-26

SBS Interns' Digest

An attempt to share knowledge

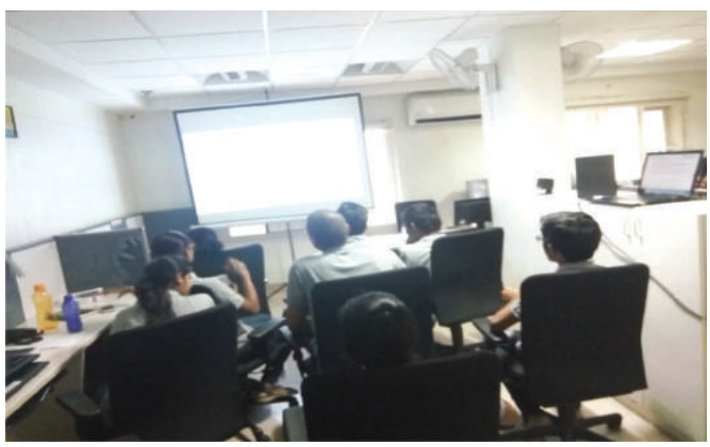


By

Interns of SBS and Company LLP

SNAPSHOTS OF LAST MONTH SATURDAY SESSIONS

Board Meeting Vs. General Meetings of the Company (Part-2) - B. Venkata Krishna



SA 315-"Identifying & Assessing the Risk of Material Misstatements through understanding entity & IT's environment - P. Ashok Reddy

Refund of CENVAT Credit Rule 5 of CCR, 2004 - Priya Singh

SA 300 Audit Planning - G. Chandra Shekar

CONTENTS

INCOME TAX ACT, 1961

TAX CONSEQUENCES ON TRANSFER OF RESIDENTIAL HOUSE PROPERTY

Contributed by B. Venkata Krishna Rao & Vetted by CA Ram Prasad

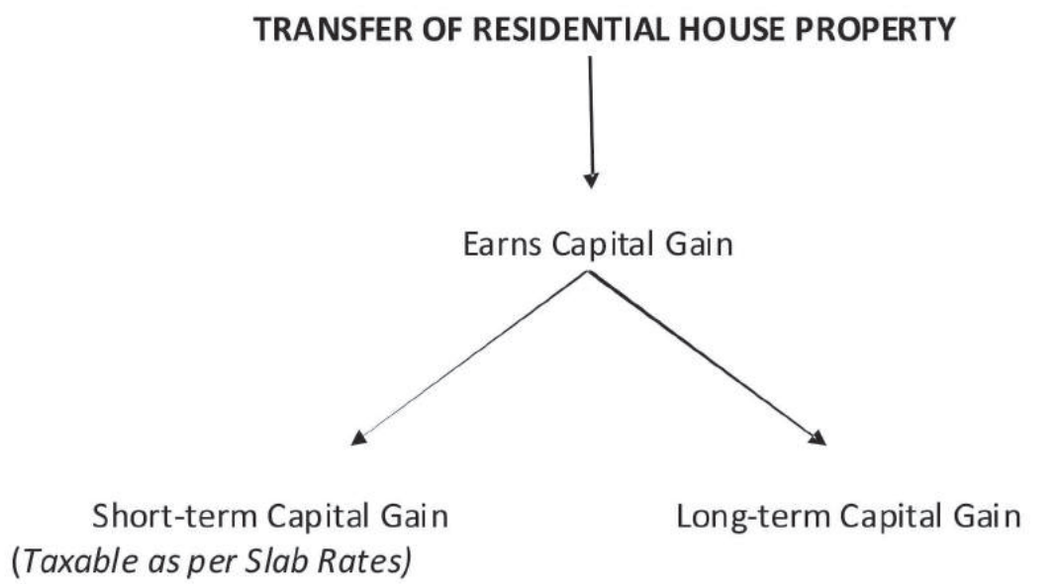
A person may sell his Residential House Property either to construct or acquire a new house property or due to shift of his residence from one place to another place.

a. Construct or Acquire New House Property, in this case he might be selling the existing residential property either to construct or purchase a new Residential House Property (or) he might have already started constructing or purchased and selling the existing property for paying back such dues.

b. Shift of residence from one place to another place, in this case he is selling the property to buy another property in the place where he is relocating.

In the above two cases, the said transaction shall be called as transfer of capital asset and would require the transferor to pay income tax. The article herein makes an effort to dwell upon the aspects of short term capital gain and computation thereof, long term capital gain, its computation and exemptions thereon.

Transfer of house property may earn capital gains, as described in the below chart:



Short-term Capital Gain:

"Short-term capital gain" means capital gain arising from the transfer of a short-term capital asset **[sec. 2(42B) of Income Tax Act,1961].**

"Short-term capital asset" means a capital asset held by an Assessee for not more than 36 months immediately preceding the date of its transfer **[sec. 2(42A) of Income Tax Act,1961].**

Computation of Short-term Capital Gain

1. Sale Consideration
   (Full value of consideration or Stamp value whichever is higher) [1]
2. Deduct the following:
   a. Expenditure incurred wholly and exclusively in connection with such transfer
   b. Cost of acquisition and
   c. Cost of improvement
3. The balancing amount is capital gain

For example, Mr. Krish purchases a house property for Rs. 50 lakhs on 1st May 2014. Further spends an amount of Rs. 10 lakhs for renovation on 1stApril, 2015.Mr. Krish transfers the residential house property for Rs. 65 lakhs on 31stApril 2015.(Stamp Value is Rs. 99 lakhs)

Computation of Short-term capital gain:

1. Sale Consideration	99 lakhs
2.Deduct	
a. Expenditure	Nil
b. Cost of acquisition	(50 lakhs)
c. Cost of improvement	(10 lakhs)
3. Short-term capital gain	39 lakhs*

*Rs. 39 lakhs is treated as income under the head 'Income from Capital Gains' for the F.Y:2015-16 and taxed as per the slab rates.

Long-term Capital Gain:

"Long-term capital gain" means capital gain arising from the transfer of a long-term capital asset **[sec. 2(29B) of Income Tax Act,1961].**

"Long-term capital asset" means a capital asset which is not a short-term capital asset **[sec. 2(29A) of Income Tax Act,1961].**

[1] **Sec. 50C of Income Tax Act, 1961** – where the consideration received or accruing as a result of the transfer by an Assessee of a capital asset, being land or building or both, is less than the value adopted or assessed or assessable by stamp valuation authority then such value so adopted or assessed or assessable shall form the full value of consideration.

Computation of Long-term Capital Gain

1. Sale Consideration
   (Full value of consideration or Stamp value whichever is higher)**[Refer to footnote 1]**
2. Deduct the following:
   a. Expenditure incurred wholly and exclusively in connection with such transfer
   b. Indexed Cost of acquisition and
   c. Indexed Cost of improvement
   d. Exemptions under sec 54.
3. The balancing amount is capital gain

Exemptions to Capital gain arising from the transfer of residential house property:

Section: 54 & 54F of Income Tax Act, 1961

Applicability: Individual or HUF.

Nature of Asset: The asset should be a residential house whereas income from such property is taxable under the head "INCOME FROM HOUSE PROPERTY" and it should belong- term capital asset.

Conditions:

I) The Assessee has purchased a residential house property within a period of 2years from the date of such transfer or within a period of 1year before the transfer or has constructed a residential house property within a period of 3years from date of such transfer.[2]

ii) In case of compulsory acquisition, the above periods start from the date of receipt of compensation.

iii) If the amount of capital gain is not utilised by the Assessee for purchase or construction of new residential house property before the due date for furnishing of return then it shall be deposited by the Assessee in CAPITAL GAIN ACCCOUNT SCHEME with specified banks(excluding rural banks).

iv) The new residential house property so constructed or purchased should not be transferred within 3years from date of its purchase or construction.

v) If the new residential house property so constructed or purchased is transferred within 3years from date of its purchase or construction then the cost of acquisition to be considered for calculating capital gain will be reduced by the amount of long term capital gain exempted earlier under sec. 54 of Income Tax Act, 1961. [for further clarification, see the illustration below]

For example, Krish transfers a residential house property in Agra for Rs. 25, 40,000 on 23rd April 2014, which was purchased by him on 20th April 1987, for Rs. 2, 90,000. On 16th June 2014, he purchases a house in Delhi for Rs. 12, 00,000 for the purpose of residence of his daughter.

[2]As per Finance Bill 2014, benefits under sec. 54 and 54F for investment in purchase or construction of residential property has been restricted to one property and the property in India.

Computation:

Sale proceeds	25,40,000
Less: Indexed cost of acquisition [Rs. 2,90,000*852/133]	(18,57,744)
Capital Gains	**6,82,256**
Less: Exemption under section 54	(6,82,256)*

Capital gains chargeable to tax for the assessment year 2015-16	**nil**

*Exemption under Sec. 54 can be availed to the extent of lower of Cost of new house property purchased or Capital gains from such transfer.

In the above case, on 18th July 2015, Krish transfers the house property in Delhi for Rs. 16,90,000.

Computation:

Sale proceeds	16,90,000
Less: Cost of acquisition	(5,17,744)*
Short-term capital gain	**11,72,256**

*Since the house purchased on 16th June 2014 was sold before 3 years, cost of acquisition reduces by the amount so claimed as exemption under sec. 54 of Income Tax Act, 1961.

Cost of acquisition is Rs. 5,17,744 [i.e., 12,00,000-6,82,256]

FAQ's:

Q: Should the New Residential House Property purchased by availing sec.54 exemption need to be in the name of Assessee only?

A: No, New Residential House Property purchased by availing sec.54 exemptions need not be only in Assessee name. This was clarified in the Judgement given in the case of *CIT v. Kamal Wahal [2013]on January 11, 2013 at High Court of Delhi.*

Facts of Case:

The Assessee sold his joint property which gave rise to proportionate capital gains. He claimed deduction under Sec. 54F by investing sale proceeds in acquisition of vacant plot and purchase of a residential house property in the name of his wife.

Taking a view that under Sec. 54F, investment in residential house should be in the Assessee's name, the Assessing Officer denied deduction in respect of investment in residential house purchased by Assessee in his wife's name.

The Commissioner (Appeals) allowed the Assessee's claim. The tribunal confirmed the order of Commissioner (Appeals), holding that Sec. 54F, being a beneficial provision enacted for encouraging investment in resident houses, should be liberally interpreted.

However, **it is better to purchase in the name of Spouse and Minor Children only as there were controversy judgements in few cases** *{Income Tax Officer v. Ganta Vijaya Lakshmi [2013] on July 22, 2013 at ITAT Visakhapatnam Bench}&{Assistant Commissioner of Income-tax v. Girish Dharod [2013] on July 4, 2013 at ITAT Hyderabad Bench 'B'}*

Q: Whether New residential House Property so purchased claiming exemptions under sec. 54 can be transferred to another person out of love and affection within 3 years from the date of purchase of the said property?

A: Yes, the new house property purchased availing exemptions under Sec. 54 can be transferred out of love and affection within 3 years. This was clarified in the Judgement given in the case of *Income Tax Officer v. Abdul Hameed Khan Mohammed [2015] on December 29, 2015 at ITAT Chennai Bench 'B'.*

Facts of Case:

The Assessee owned a residential property. He had sold the said property in April, 2010 and invested the sale proceeds in August, 2010 in another residential property. In November, 2010, he had settled the new property to his daughter out of love and affection. In the return filed for the Assessment Year 2011-12, the Assessee claimed exemption under Sec. 54 in respect of capital gains arising on sale of property. He submitted that the settlement in favour of the daughter was a gift falling under Sec. 47(iii) and was not taxable.

The assessing officer held that the settlement did not cover under Sec. 54(i) or 54(ii) and accordingly denied exemption.

The Commissioner (Appeals) allowed the claim of the Assessee for exemption under Sec. 54.

Q: Whether exemption under Sec. 54F is allowed for Assessee though he was unable to get possession of Residential House Property?

A. Yes, Section 54F relief cannot be denied to Assessee when he has invested entire sales consideration in purchase of residential house but he is unable to get possession of flat, which is under construction, due to fault of builder. This was clarified in the judgement made in case of *Income Tax Officer v. Rajeev B. Shah [2016] on July 8, 2016 at ITAT Mumbai Bench 'SMC'.*

Facts of Case:

The Assessee has invested amount in purchase of residential house within the stipulated period prescribed u/s 54F of the Act. But, it is not in the Assessee's hand to get the flat completed or to get the flat registered in his name, because it was incomplete. The intention of the Assessee is very clear that he has invested almost the entire sale consideration of land in purchase of this residential flat. It is another issue that the flat could not be completed and the matter is pending before the Hon'ble Bombay High

Court seeking relief by the Assessee by filing suit for direction to the Builder to complete the flat. It is impossible for the Assessee to complete other formalities, i.e., taking over possession for getting the flat registered in his name and this cannot be the reason for denying the claim of the Assessee for deduction u/s 54 of the Act. Thus, Assessee is allowed for deduction under Section 54F.

Q: Whether exemption under Sec. 54F is allowed for Assessee though he has filed Income Tax Return after the due date as per Sec. 139(1)?

A. Yes, Assessee can claim relief under Section 54F although he has filed his Income Tax Return belatedly under Section 139(4), i.e., 'extended due date' subject to conditions as mentioned in the below Facts. This was clarified in the judgement made in case of *Income Tax Officer v. G. Ramesh[2016] on June 22, 2016 at ITAT Chennai Bench 'A'.*

Facts of Case:

Assessee sold the properties situated at Nelankarai and Chenglepet and declared capital gains from these two properties at 77,15,927/. The Assessee claimed exemption u/s. 54F of the Act on investment in a flat for `68,82,120/and thereby declared net taxable capital gains at Rs. 8,33,807/-.

The AO was of the opinion that the Assessee has filed the return of income not u/s.139(1) of the Act and it was filed belatedly u/s.139(4) of the Act, as such the Assessee is not entitled for exemption u/s. 54F of the Act.

The AO in this case out rightly rejected the claim of Assessee that the Assessee is not utilized the capital gains on transfer of capital asset in investment in residential house as specified in section 54F(1) of the Act on the reason that the Assessee has not filed the return of income within due date in term of sec.139(1) of the Act. However, if Assessee wants claim of exemption from payment of income tax by retaining the cash, then the said amount is to be invested in the said account notified by Central Government on this behalf. If the intention is not to retain cash but to invest in construction or any purchase of the property and if such investment is made within the period stipulated therein i.e. Section 139(4), then section 54F(4) is not at all attracted and therefore, the contention that the Assessee has not deposited the amount in the bank account as stipulated and therefore, he is not entitled to the benefit even though he has invested the money in construction is also not correct.

In view of the above, ITAT has inclined to remit the issue to the file of AO to examine the fulfilment of the conditions u/s. 54F of the Act through intermediary period that is from the date of sale of capital asset to the date of actual investment in residential house. Accordingly, the issue is remitted to the file of AO for fresh consideration after giving adequate opportunity of hearing to the Assessee.

Q: Whether exemption under Sec. 54F is allowed for Assessee if he possesses one Residential House Property and another House Property for commercial Purpose?

A. Yes, exemption u/s. 54F is allowed for Assessee although if he possess one Residential House Property and another Property which is used for Commercial Purpose. This was clarified in the judgement made in case of Commissioner of Income Tax *v. I. Ifthiqar Ashiq[2016] on February 8, 2016 at High Court of Madras*

Facts of Case:

Assessee had one residential house and one commercial flat in Chennai, from out of both of which, he was deriving income. He also had a land in which was sold and a house property was purchased. The Assessee sold a land owned by him at Neelankarai. The total sale consideration was Rs. 1,14,88,000. The Assessee claimed that the entire sale consideration was invested in the construction of a residential house at Kodaikanal. Therefore, he claimed exemption under section 54F.

The Assessing Officer disallowed exemption under section 54F on ground that the case was covered by the proviso to section 54F(1). On appeal, the Commissioner (Appeals) confirmed the order of the Assessing Officer. On second appeal, the Tribunal allowed the appeal of the Assessee on the ground that section 22 uses only the expression 'building', without qualifying it with an adjective 'residential'. On appeal, the revenue contended that the Assessee's claim for deduction under section 54F could not be allowed as Assessee owned two properties on the date of transfer of original assets and income from two properties were chargeable to tax under the head 'income from house property'. It was further contended that the Assessee's case is hit by clauses (a)(i) and (b) of the proviso to section 54F.

Under the substantive part of section 54F(1), the capital gain arising from the transfer of any long-term capital asset, not being a residential house, shall not be subjected to the taxation provisions, if the Assessee had within the period of one year before or two years after the date on which the took place, purchased a residential house. Alternatively, he should have constructed one residential house in India within a period of three years. If these transfer conditions are satisfied, the capital gain will be dealt with in accordance with clauses (a) and (b) of sub-section (1) of section 54F.

In view of the above, the substantial question of law is answered in favour of the Assessee.

"Climb the mountain so you can see the world, not so the world can see you"

This article is contributed by B. Venkata Krishna Rao, Intern of SBS and Company LLP. The author can be reached at interns@sbsandco.com

INDIRECT TAX

REVERSAL OF CENVAT CREDIT WHEN GOODS ARE REMOVED AS SUCH

Contributed by Priya Singh & Vetted by CA Sri Harsha

INTRODUCTION:

The Manufacturer or Service Provider buys inputs and capital goods in order to use it for provision of taxable service or for manufacturing the final products. The assessee avails the credit of excise duty on such inputs/ capital goods which is utilised while making payment of output tax as per Rule 4 of CENVAT Credit Rules, 2004.

In manufacturing Industry, it is a common practice to remove goods (inputs/capital goods) from factory place without even using it in the manufacturing activity. There could be various reasons for clearing goods as it is from factory place. Few reasons are as follows:

i. Assessee buys inputs/ capital goods in order to sell them as it is, at higher amount and make profits, or
ii. The quality of goods might not be up to the mark for using it in manufacturing and so rejected it and return back or sell to another person or the goods might be sold as it is if it is not needed because of change in production plan etc. which occasionally happens;
iii. Goods sent outside to job-worker

REMOVAL OF INPUT/ CAPITAL GOODS *"AS SUCH":*

Sub-Rule 5 of Rule 3 of CCR ,2004 is defined as follows;

> When inputs or capital goods, on which CENVAT credit has been taken, are removed as such from the factory, or premises of the provider of output service, the manufacturer of the final products or provider of output service, as the case may be, shall pay an amount equal to the credit availed in respect of such inputs or capital goods and such removal shall be made under the cover of an invoice referred to in rule 9.
>
> Provided that such payment shall not be required to be made where any inputs or capital goods are removed outside the premises of the provider of output service for providing the output service
> Provided further that such payment shall not be required to be made where any inputs are removed outside the factory for providing free warranty for final products

The manufacturer or Service provider might remove the goods as such i.e. the inputs/capital goods are removed without making any change or without using it at all, in providing service or in manufacturing activity then in such cases, it is as good as trading of such goods therefore no excise duty is leviable. In such cases, if the assessee has availed credit of excise duty at the time of purchase then s/he should reverse the credit to the extent of the value of excise duty paid at the time of purchase. The credit shall be reversed by reducing the credit balance by debiting the amount. Such reversal should be specified in the Excise invoice.

Excise Invoice:

It is a document which the manufacturer of excisable goods issues to customer while removing the goods from place of removal which states the list of excisable goods given to the customer, excise duty applicable on it and how much credit is reversed by manufacturer, if any.

Let us analyse the circumstances under which goods are removed 'as such':

A. Goods removed to job-worker premises by the manufacturer:

It is a common practice that principal manufacturer provides inputs/capital goods required for making the excisable product. In this case, principal manufacturer supplies goods to job-workers.

Inputs: The manufacturer can avail credit of the duty paid on the inputs supplied (as such) to job-worker under sub-rule 5 (a)(i) of Rule 4 of CCR,2004 provided the inputs are received back by manufacturer within 180 days of this being sent to job-worker. The period of 180 days shall be counted from the date goods being sent from factory or premises of output service provider.

Initially, there was huge litigation going on in cases, where credit is availed without inputs being brought to the factory and directly being sent to premises of job worker. The credit on inputs shall be available only when such inputs reach the factory of the manufacturer. When the inputs were being directly sent to the premises of job worker without getting them to the factory of the manufacturer, the credit used to be denied.

To overcome this anomaly, recent changes are made to provisions such that credit can be availed even if the inputs are being sent directly to premises of job worker. However, the time limit of 180 days shall be still applicable and this period will be counted from the date of receipt of inputs by job-worker. Proper documents have to be prepared.

Capital goods: When the manufacturer purchases capital goods for sending it to Job-worker premise as such, the manufacturer can avail credit of the duty paid on capital goods provide proper challans are kept and the capital goods are received back from job-worker within 2yrs from the day of removing from factory.

Even capital goods can also be directly sent to the premises of job worker without receiving them in the factory of manufacturer. The credit shall be available even in such cases. However, the time limit of 2 years shall be still applicable and this period will be counted from the date of receipt of capital goods by job-worker.

B. Trading of goods:

The assesse (being service provider or manufacturer) might engage into trading of inputs which he also uses in manufacturing activity. In such case inputs are imported and then some are used in manufacturing and some are sold in domestic market at higher price in order to gain profit. The manufacturer charges higher amount from customer and collects excise duty. Usually, the assesse pays the excise duty to government by utilising the excess credit balance lying in the CENVAT credit account which is raised from the goods used in final product manufactured for export purpose.

Point to be noted is the sub-rule 5 doesn't allow the assesse to collect excise duty from the customer since there is no manufacturing undertaken and should reverse the credit to the extent of credit amount availed and shouldn't charge anything in the name of excise duty. This can be understood well with the Case Law *"Commissioner of Central Excise, Ahmedabad-II v. Inductotherm (I) (P.) Ltd."* passed in favour of revenue on 28th June,2012.

"Commissioner of Central Excise, Ahmedabad-II v. Inductotherm (I) (P.) Ltd."

Facts of the case:

Assessee was a manufacturer of induction furnace and other engineering goods. It was found that assessee was clearing certain parts of induction furnaces without any manufacturing activity on 'as such' basis at a higher value and was collecting excise duty thereon. The alleged excise duty was being paid by utilization of CENVAT Credit availed on the inputs used for export product. Thus, assessee was encashing unutilized CENVAT credit by raising value of the goods to be cleared as such and collecting the same from the buyers of such goods. The revenue objected the same and Commissioner confirmed the demand of such amountunder Section 11 D of Central Excise Act,1944 along with applicable interest and penalty.

Section 11D (1), it states that if there is any excess amount recovered from the customer in the name of duty of excise should be deposited to the credit of Central Government.

The assessee file an appeal with Tribunal which was in assessee's favour. The revenue was not satisfied with the decision and so filed the appeal before Gujarat High court.

Grounds of Gujarat High Court:

The Court gave judgement in favor of revenue on the grounds that;
The assesse had cleared goods as such where no manufacturing activity is undertaken and so he shouldn't charge anything in the name of excise duty as the Sub-rule 5 does not permit the collection of higher amount in the guise of duty of excise and deposit it to department.
Though the payment made through credit is as good as payment of duty but such utilization is not allowed for payment of duty which is not authorized as per the said rule.
Where any duty has been collected in excess of excise duty required shall be paid to the government in cash only.

Inference:

This explains that this sub-rule restricts the manufacturer/Service provider to mint money by charging higher amount through representing it as excise duty and thereby encashing the unutilized credit early.

C. **Removal of Capital Goods after being put to use:** Sometimes the manufacturer/ service provider might remove the capital goods after being put to use. In such cases, the manufacturer/service provider shall pay excise duty/reverse the credit based provisions contained in Rule 3(5A). However, if capital goods are removed as scrap, then excise duty has to be paid on transaction value.

D. **If capital goods/inputs before being put to use has been written off fully/partially:** When the assessee writes off the value of goods in the books of accounts, on which credit is already taken, because the goods have become obsolete and the net realisable value is minimal. In such case, their value is assigned

to zero in the balance sheet by writing off their value. Hence, the assessee shall pay the excise duty/ reverse the credit equivalent to the credit taken on such goods wholly or proportionately as the case may be, from the time the assessee starts writing off the value.

E. **Remission of duty under Rule 21 of Central Excise Rules,2002 (for brevity "CER,2002"):**If the manufacturer is getting remittance of excise duty payable on the finished goods which is claimed before the Principal Commissioner/Commissioner that the goods are unfit for consumption or sale and satisfies the provision given under Rule 21 of CER,2002. In such case, CENVAT credit taken on inputs and input services used in the manufacture of such goods shall be reversed.

F. **Capital goods when removed as such in first year:** Generally, credit on capital goods can be availed only up to 50% of the total duty paid in the first year. This implies that if the capital goods are removed as such then the assessee (both manufacturer as well as service provider) shall reverse only 50% of the total credit which is unfair benefit providing to the assessee. Hence proviso is inserted in sub-rule 2(b) of Rule 4 of CCR,2004 stating that;

"Provided that the CENVAT credit in respect of capital goods shall be allowed for the whole amount of the duty paid on such capital goods in the same financial year if such capital goods are cleared as such in the same financial year"

So, if this proviso is read with the sub-rule 5 then the assessee in this case can avail 100% credit in the first year and shall be reversed at the time of removing the goods as such.

G. **Capital Goods/Inputs removed by the Service provider for provision of output service:** If the service provider removes any capital goods to any other place for the purpose of rendering service, in such case, the credit taken on such capital goods or inputs should not be reversed. The service provider is still eligible for utilising such credit.

TIME OF REVERSAL OF CREDIT OR PAYMENT F DUTY:

The reversal of credit of excise duty can be made by debiting the CENVAT credit. However, if the payment is made in cash then such payment shall be made by 5th of the following month except in the month of March, this payment shall be made by 31st March.

Months	***Due date***
April to February	5th of the following month
March	31st day of the month of March

CONCLUSION:

This rule enables the buyer (manufacturer/service provider) to avail the credit when goods are purchased from the assessee so that there would not unjust enrichment on the part of utilisation of credit to the seller (assessee).

"Great spirits have always faced violent opposition from mediocre minds"

- Albert Einstein

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AUDIT

SA - 580

Contributed by Samatha Gayam & Vetted by CA MHS Bhyrav

Introduction

As Ronald Regan rightly said, "Trust, but Verify".The fact that one has to trust beyond oneself is more of a psychological challenge.

As per section 143(3)(a) of the Companies Act,2013 the auditor's report shall also state whether he has sought and obtained all the information and explanations which to the best of his knowledge and belief were necessary for the purpose of his audit and if not, the details thereof and the effect of such information on the financial statements.

Section 143(9) stated every auditor shall comply with the auditing standards.

As per Section 147 of Companies Act,2013 If an auditor of a company contravenes any of the provisions of section 139, section 143, section 144 or section 145, the auditor shall be punishable with fine which shall not be less than twenty-five thousand rupees but which may extend to five lakh rupees.

According to SA 200 "Basic Principles Governing an Audit" Audit is the independent examination of financial information of any entity, whether profit oriented or not, and irrespective of its size or legal form, when such an examination is conducted with a view to expressing an opinion thereon.

This Standard on Auditing (SA) deals with the auditor's responsibility to obtain written representations from management and, where appropriate, those charged with governance.

List of Auditing Standards Containing requirements of Written Representations

SA 230 – Audit Documentation
SA 240 – The Auditor's Responsibility relating to fraud in an Audit of Financial Statements
SA 250 – Consideration of Laws and Regulations in an Audit of Financial Statements
SA 260 – Communication with the those charged with Governance
SA 450 – Evaluation of Misstatements Identified during Audit
SA 501 – Audit Evidence- Specific Considerations for Selected Items
Sa540 –Auditing Accounting Estimates, Including Fair Value Accounting Estimates and Related Disclosures
SA 550 – Related Parties
SA 570 – Going Concern

Effective Date: This SA 580 is effective for audits of financial statements for periods beginning on or after 1st April, 2009.

Meaning of Written Representation

- A written statement by management provided to the auditor to confirm certain matters or to support other audit evidence.
- Written representations in this context do not include financial statements, the assertions therein, or
- Supporting books and records.

Written Representations as a tool of Audit evidence

- Audit evidence is all the information used by the auditor in arriving at the conclusions on which the audit opinion is based. Accordingly, similar to responses to inquiries, written representations are audit evidence.
- Written representations provide audit evidence, they do not provide "Sufficient and appropriate Audit evidence".
- Written representations do not dilute auditor's responsibility to obtain other audit evidence for matters covered by Written representations.

When is the Written Representation given?

An auditor has to obtain the written representation letter, before completion of the assignment; to ensure he has adequate information before an opinion is formed. i.e.

- The date of written representations shall be before the date of auditor's report on the financial statements.
- Written representations should cover for all Financial statements and period's referred to in the Audit report.

Management Responsibilities towards Written representations

- That Management has fulfilled its Responsibility towards Preparation and Presentation of Financial Statements.
- That It Has Provided the auditor all the information and access to all the records of the entity.
- Situation that current management were not present during all period's referred to in the auditor's report. And they may tell the Auditor that they are not in a position to give the Written representation. This fact however will not diminish the present management of its responsibilities towards the financial statements.

From whom written representations to be obtained?

- The Auditor shall request written representations from management with appropriate responsibilities for the financial statements and knowledge the matters concerned.
- In some cases, Written Representations may also be taken from a person who have specialized knowledge relating to the matters about which the written representations are requested who may include:
  - ❖ An actuary responsible for actuarially determined accounting measurements.
  - ❖ Staff engineers who may have responsibility for and specialized knowledge about environmental liability measurements.
  - ❖ Internal counsel who may provide information essential to provisions for legal claims.

Case Law:

Barings Future Singapore Vs Deloitte & Touché Singapore [2002] All ER (D) Mar

A Decision in the preliminary hearing concerning the audit by Deloitte & Touché (D & T) of Barings Futures Singapore Pvt ltd(BFS).It was noted in the course of the Bearings hearing that the BFS director who signed the Representation letters in question had little knowledge or understanding of the activities. However, the director made written statements to the effect that there had been no irregularities involving management or having material effect on the financial systems, and that the financial statements were free of material errors and omissions.

On this basis, Deloitte claimed that the representations by the BFS director were Recklessly fraudulent. Deloitte's claim failed, however, because they did not establish to the judge's satisfaction that the BFS director signed the representation letters:

- Knowing that the statements in the letters were untrue, without an honest belief in their Truth, or indifferent as to whether or not they were True;
- Knowing that he had no reasonable grounds for making statements, without an honest belief that he had reasonable grounds, or indifferent as to whether he had or not.

The Judge did, however, address the issue of the result if the Deloitte had proved that, in signing the representation letters, the director was reckless of their truth or falsity. He concluded that, had such a case for fraudulent misrepresentation been established, he would have held that he BFS was vicariously liable for the director's action, and thus Deloitte would have succeeded in their claim.

Is there any format for Written representation letter?

Written Representation letter is addressed to the auditor on the entities letter head.

If law or regulation requires management to make written public statements about its responsibilities, the relevant matters covered by such statements need not be included in the representation letter.

Auditor to consider these Factors for above

1.Includes the matters covered in terms of audit engagement

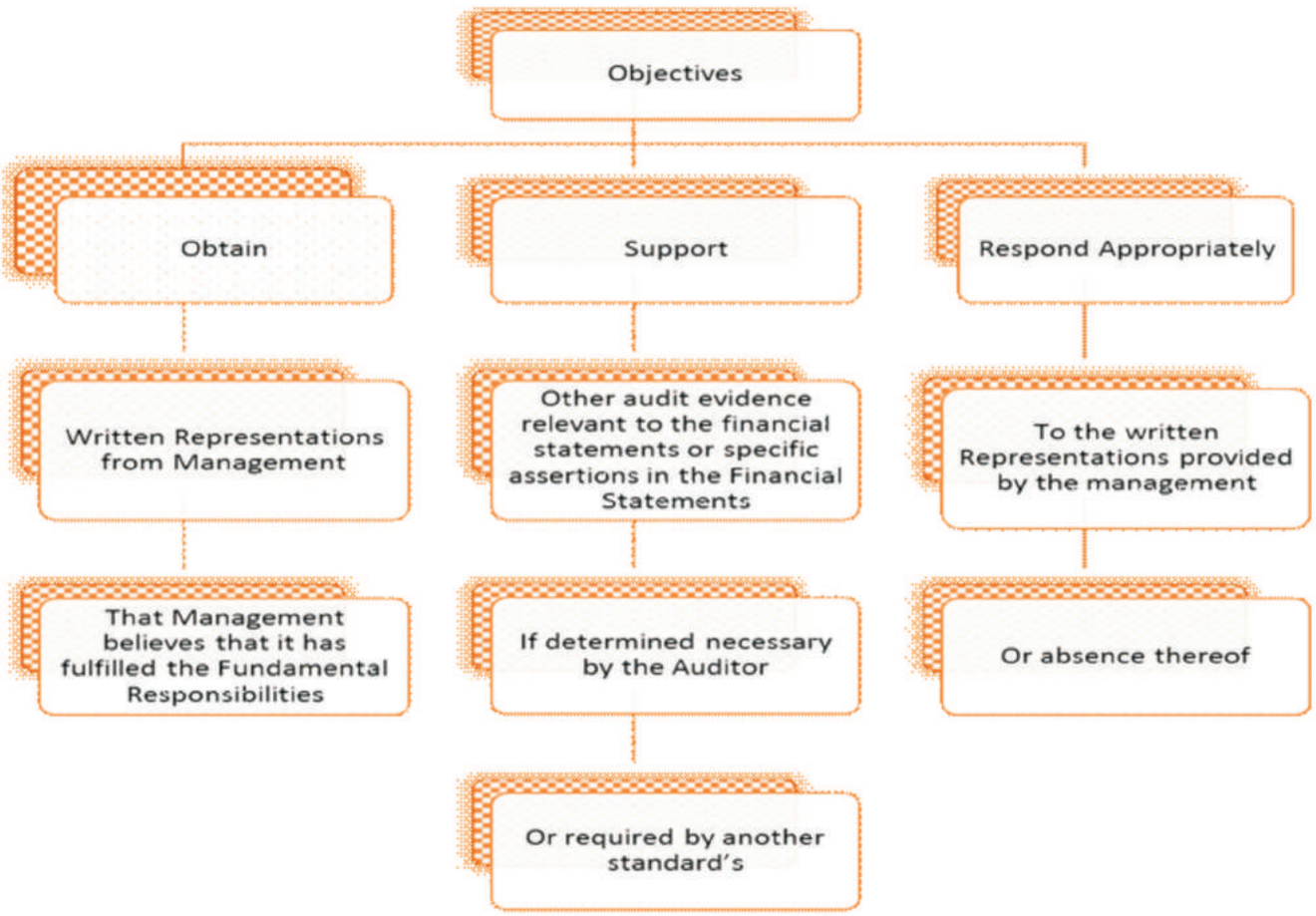
2.That above Written representation is given by the person from whom the auditor wants the Representation.

3.Copy provided to auditor before the date of audit report

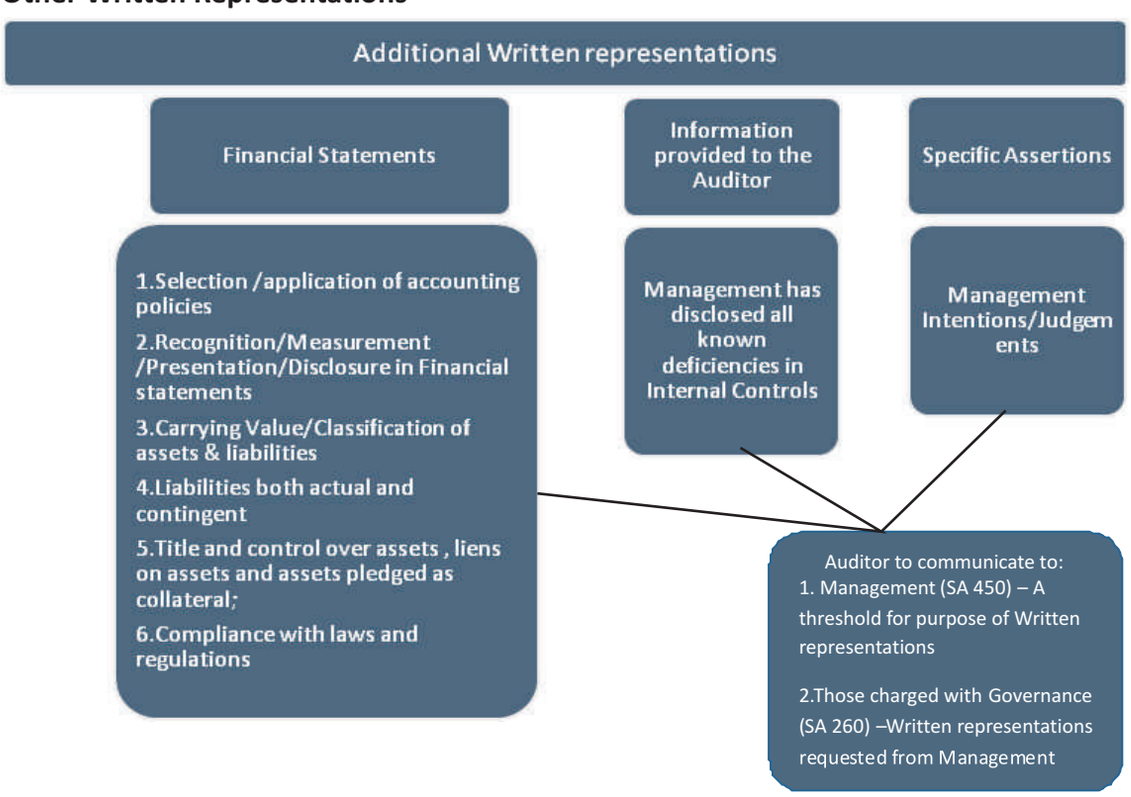
SA 580 gives an illustrative format for the letter, but this may be modified to suit the audit requirements.

The idea of the representation letter, is to address the grey areas where information is inadequate and is not known to outsiders. But when information is already available for example, CFO and CEO of a listed company are required to certify that the internal controls are in place is a *SEBI requirement as per Clause 49 of the Listing Agreement pertaining to 'Corporate Governance',* and is also disclosed in the Annual Report, need not be mentioned in the Representation letter.

Objectives of Auditor



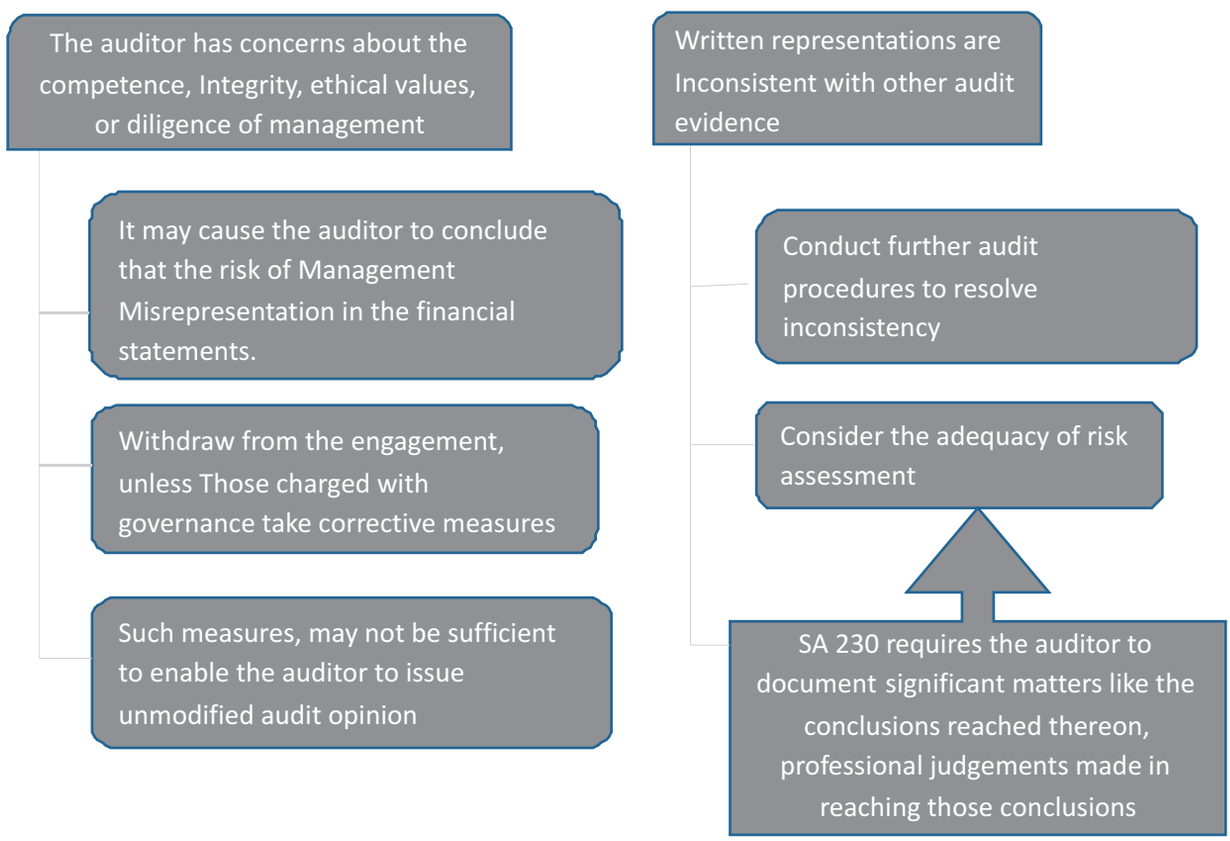
Other Written Representations



What if representations are not provided?

1.Discuss the matter with Management
2. Re-evaluate integrity of management
3.Evaluate effect on reliability of representations &audit evidence
4.Take appropriate actions and determine the possible effect on the opinion in the auditor's report in accordance with SA 705

Doubts as to the reliability of Written Representations



Conclusion:

"Let every eye negotiate for itself and trust no agent", so said Shakespeare in Much Ado About Nothing. The management of the company is well informed about the internal environment and day to day activities of the company as compared to the auditor who visits the company for a comparative short duration to conduct the audit. In such situation, the auditor has to discuss with the management and in certain cases relay on the management's view / discussion while forming opinion on the financial statement. Thus, as important audit evidence regarding the information provided by management, a written representation should be taken from the management of the company.

"Don't make excuses for why you can't get it done. Focus on all the reasons why you must make it happen"

- Ralph Marstoon

This article is contributed by Samatha Gayam , Intern of SBS and Company LLP. The author can be reached at interns@sbsandco.com

DIRECT TAX

JUDGEMENTS - INCOME TAX UPDATES

RAYALA CORPORATION PVT. LTD VS ASST. CIT *(SUPREME COURT)*

Issue: - Income of the Company engaged in the business of leasing out its property is chargeable under the head "House Property" or "Income from Business"?

Facts: - A Private Limited Company engaged in the business of renting of properties. As per the Memorandum of Association of the company its business is to deal into real estate and also to earn income by way of rent by leasing or renting of properties belonging to the company.

Assessee Contention: - It is in the business of renting its properties and is receiving rent as its business income and the said income should be taxed under the head "Profits and Gains from Business or Profession".

Revenue Contention: - Leasing and letting out shops and properties is not the main business of the Assessee as per Memorandum of Association and therefore, the income earned by the Assessee should be treated as income earned by the Assessee should be treated as income from house property. Rent should be the main source of income or the purpose for which the company is incorporated should be to earn income from rent so as to make the rental income be income taxable under the head "Profits and Gains from Business or Profession"

Supreme Court Judgment- Relying on Supreme Court Judgment in *Chennai Properties* and Investment Ltd the High Court was not correct while deciding that the income of the Assessee should be treated income from house property.

Supreme Court in case of *Chennai Properties* held that if Assessee is having his house property and by way of business he is giving the property on rent and if he is receiving rent from the said property as business income, the said amount, even if it is the nature of rent, should be treated as "Business Income" because the Assessee is having a business of renting his property and the rent which he receives is in the nature of his business income.

CIT VS KNIGHT FRANK (INDIA) P. Ltd *(DELHI HIGH COURT)*

Issue: - Whether Service Tax billed for rendering services part of trading receipts? Whether Unpaid Service Tax liability is disallowed U/S 43B?

Facts: -Assessee engaged in the business of real estate consultancy and property management services. Assessing Officer included service tax billed by the Assessee as a part of trading receipts by invoking the provisions of section 145A[1] and also invoked provisions of section 43B in respect of the unpaid service tax liability though the Assessee has not claimed deduction of the same while determining its income.

[1]Valuation of purchase and sale of goods and inventory for the purpose of determining income chargeable under head "PGBP"

AssesseeContention: - The Section 145A has no application as service tax was not mentioned therein.

Since the Assessee has not claimed deduction on account of service tax payable to the Government section 43B of the Act would not have any application.

Revenue Contention: Section 145A would apply as it is not restricted only to manufacturing and trading companies.

Service tax stands on the same footing as excise duties, sales tax and other taxes which are collected to be paid over to the Government and hence section 43B is applicable.

High Court Judgment: - It is very clear that Section 145A(a)(ii) covers cases where the amount of tax, duty etch is actually paid or incurred by the assesse to bring the goods to the place of its location and condition as on the date of valuation. In this the respondent is rendering services. The section it is self-evident that the same would not apply to the service tax billed on rendering of services. Service tax billed has no relation to any goods nor does it have anything to do with bringing the goods to a particular location.

Further, it is to be noted that Service Tax was first introduced in India by Finance Act, 1994. Section 145A of the Act was first introduced into the Act only by Finance (No.2) Act, 1998 w.e.f. 1st April, 1999. It was thereafter substituted by Finance (No.2) Act, 2009 which is identical, except for addition of clause (b), dealing with interest. However, the Parliament did not while substituting it; deem it fit to explicitly include the valuation of Services therein. Thus, it is clear that the legislature never intended to restrict the applicability of Section 145A of the Act only to goods and not extend it to Services.

Since Assessee had not claimed any deduction on the account of service tax payable there can be no occasion to invoke section 43B of the Act.

ITO VS DR. VANDANA BHULCHANDANI ***(ITAT MUMBAI)***

Issue: - Whether in case of Joint Ownership capital gain on sale of property need to be disclosed and offered to tax by owners to the extent of their respective share where the funds for investment has in fact flown only from one party to the transaction?

Facts:- Assessee is a medical professional and has not disclosed sale of the property which was owned by her along with her husband. During the course of proceedings of assessment Assessee submitted that though the property were in the joint names the property was purchased out of funds from her husband account and the same was shown in his balance sheet. Her husband has disclosed the capital gains arising from transfer of property in his return of income.

AssesseeContention: - In the past(AY 2005-06) the AO had accepted the fact that though the Assessee name appeared as a co-owner the entire investment in the acquisition thereof was made by her husband. The action of the AO (AY 2009-10) to bring tax of 50% of the STCG in the Assessee hand is erroneous as the same had undisputedly been disclosed by her husband in his return of income.

Revenue Contention: -The whole arrangement surrounding the transaction in respect of the property was worked out to avoid legitimate tax and defraud the revenue as the profit on sale of the property was set off against short term capital gain on sale of shares.

Since Assessee was shown as first holder of the property she liable to pay tax for 50% of short term capital arising on sale of the said property.

Tribunal Judgment:- AO has disputed the fact that the Assessee has not purchased the said property but rather the same was purchased by the Assessee husband out of his own funds.

Assessee husband reflected the said property in his balance sheet from AY 2005-06 till its sale. In this factual matrix of the case we concur with the finding that the STCG arising on sale of the said property is to be assessed in the hands of Assessee husband.

IMPORTANT UPDATES: -

1. **Circular 30/2016-** CBDT has issued a Circular streamlining the assessment of foreign shipping company's U/S 172. CBDT lays down procedure for issuing voyage NOC in case where the entire cargo belongs to single foreign shipping company belonging to a country with full DTAA relief and where the cargo belongs to number of foreign shipping companies each belonging to a country with full DTAA relief. It also provides that Master of the ship shall obtain voyage NOC from AO having jurisdiction over the port in cases not covered by above.

2. **Notification of Protocol-** The Protocol for amendment of the Convention for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital gains between India and Mauritius was signed by both countries on 10th May, 2016. After completion of internal procedures by both countries, the Protocol entered into force in India on 19th July, 2016 and has been notified in the Official Gazette on 11th August, 2016.

3. **FAQ (IDS)-**

   - ❖ Period of holding of asset declared under the scheme shall be based on actual date of acquisition of asset (evidenced by registered deed with any authority of the State Government). However, the benefit of indexation is available from 01/06/2016 only (in case of future sale of the same).

   - ❖ Amendment to IDS Rules provides that where acquisition of an immovable property is evidenced by registered deed, an option is available to the declarant to declare the FMV of such property by applying of CII to the stamp duty value of the property.

   - ❖ Registration U/S 12A shall not be cancelled solely on the basis of the information furnished in the declaration filed under the scheme.

   - ❖ Where the Assessee has claimed accelerated deduction (> 100%) on account of bogus donation has to declare the amount of deduction claimed under the scheme.

- Where fictitious amount of loans, creditors, advances, share capital, payable etch are shown in the audited balance sheet but are fictitious in nature such fictitious amount of liabilities can be disclosed under the scheme provided they are not directly linked to acquisition of a particular asset in the balance sheet. However, if there is a direct link between the liability and the asset acquired then that the amount to be declared shall be FMV of the acquired property as on 01/06/2016.

- Declarant can revise the fair market value of immovable property declared in the declaration already filed on account of the amended provisions of the Income Declaration Scheme Rules, 2016 even in a case where such revision may result in downward revision of the declared amount in respect of the immovable property.

INDIRECT TAX

INDIRECT TAX UPDATES

CARLSBERG INDIA PVT LTD VS UNION OF INDIA AND ORS: DELHI HIGH COURT 2016-TIOL-1646-HC-DEL-ST:

The manufacture of alcoholic beverage for human consumption on contract basis has to be viewed as service rendered by one party to another (Job Worker) and therefore amenable to service tax. The High court applied the 'Pith and Substance doctrine' as well as 'aspect doctrine' and concludes that Parliament is competent to legislate,with reference to Entry 97 of List I, service tax on such activity.

FACTS:

1. Kool Breweries Limited (for brevity 'KBL') merged with Carlsberg India Pvt. Ltd. (for brevity 'CIPL'), who were into the business of manufacturing and sale of beer under brand name of 'Kingfisher' for UBL. The Petitioner (CIPL/KBL) was responsible for complete value of chain right from procurement of raw material to distribution of beer on behalf of UBL. The Director General of Central Excise Intelligence initiated investigation and issued SCN stating that the assessee (petitioner) is rendering'Business Auxiliary Service 'and thereby claimed service tax with appropriate interest and penalty.

2. The Petitioner challenged the constitutional validity of Section 66B read with section 65B (40) and section 66D of Finance Act,1994 as amended by Finance Act 2015, which levies service tax w.e.f 01.06.2015 on persons who manufacture alcoholic liquor for human consumption on job work basis.

    a. The Petitioner states that Parliament lacks the legislative competence to enact the said amendments since the activity of manufacturing lies exclusively within the State legislative under Entry 51 of List II of Schedule VII of the Constitution.

    b. Also, challenged the section 113 (A)(1) of FA 2009 by which section 65(19) of FA 1994 was amended. Hence the Petitioner claimed that service tax should not be levied in such activity since it is beyond the legislation of Central Government.

HELD:

1. The Honourable High Court opined that service tax is not levied on the manufacture of alcohol but on the service aspect of the contract of manufacturing of alcohol on behalf of the principal manufacturer/brand owner.

2. The Honourable High Court was satisfied that the taxable event is the manufacture and it is amenable to states excise duty. However, when it comes to manufacture for another, in pith and substance, it is a service performed by one for another and cannot therefore fall within the ambit of Entry 51 of List II. Service tax on contract manufacturing of alcoholic beverages for human consumption can be legislated validly by the Parliament with respect to Entry 97 in List I.

3. It was held that activity of manufacture undertaken by one for another is a service and for this reason the definition of 'Business Auxiliary Service' was amended and included the activity of manufacture of alcoholic liquor for human consumption by FA 2009, which is valid. So, the challenge posed by the petitioner on this was struck down.

4. Further, the court negatives the challenge to the validity of section 66B by substituting the relevant clause in section 65B and 66D w.e.f 01.06.2015. Due to this, the manufacture of alcoholic liquor for human consumption on job-work / contract basis is made taxable under service tax.

The Honourable HC knocks down the challenges posed by Petitioner and the petition was dismissed.

FEDERATION OF HOTELS AND RESTAURANTS ASSOCIATION OF INDIA AND ORS VS UNION OF INDIA AND ORS: DELHI HIGH COURT 2016-TIOL-1730-HC-DEL-ST:

ST Provision of short term accommodation in hotels etc. envisaged in FA, 1994 is a taxable event that is entirely covered by the term 'luxuries' in the State List and, therefore, outside the legislative competence of Parliament: High Court

FACTS:

3. The Petitioners challenged the constitutional validity of levy of service tax on service portion on supply of food or any drink in hotel or restaurant, taking stand that after Constitution (Forty Sixth Amendment) Act, 1982 enabling states to levy tax on supply of food or drink as part of service as tax on "supply of sale or purchase of goods", all aspects of transaction of sale of food and beverages would fall under levy of sales tax of State (VAT).

4. They also challenged the constitutional validity of levy of service tax on short term accommodation in hotels, stating that luxury tax is levied by the State on provision of accommodation by hotels, taking power from Entry 62 of List II (State List) and thus, is exclusive matter of state list.

HELD:

1. With respect to levy of service tax on service portion involved in supply of food or beverages in restaurant/hotel, the Honourable High Court opined that the legislative carving out of the service portion of the composite contract of supply of food and drinks has sound constitutional basis, even if this is viewed as Parliament deploying a legal fiction, it is legally permissible and with the machinery provision for the levy and determination of service tax on the service portion clearly being spelt out in the Rules (Rule 2C of ST Valuation Rules 2006) themselves, the High Court upholds the constitutional validity of service tax levy on service involved in food supply.

2. With respect to service tax levy on provision of short term accommodation in hotels, the Honourable High Court observed that Delhi Tax Luxuries Act (for brevity "DTL") providing for levy of luxury tax on provision of the service of accommodation in a hotel etc. is traceable to Entry 62 of List II and the State is therefore competent to levy and collect luxury tax on such taxable event. The High Court opined that since the very same taxable event of providing service by way of accommodation in a hotel etc. is the subject matter of both levies viz., luxury tax under the DTL Act and service tax under the Finance Act, the service tax levy on accommodation service by hotels fails the foremost test of constitutionality of a Union tax. The court also observed absence of any machinery provision/rule for levy and collection of tax on accommodation as compared to levy and collection of service tax on restaurant service. Thus, the court, being satisfied that that the provision of short term accommodation in hotels etc. envisaged in Section 65 (105) (zzzzw) of the FA read with Section 65 (44) of the FA is a taxable event that is entirely covered by the term 'luxuries' in Entry 62 of List II of the Seventh Schedule to the Constitution and, therefore, held out by the High Court, to be outside the legislative competence of Parliament.

COMPANIES ACT, 2013

RULES, CIRCULARS AND NOTIFICATIONS ISSUED DURING THE MONTH OF AUGUST, 2016

Rules

❖ **The Companies (Share Capital and Debentures) Fourth Amendment Rules, 2016, Dt:12.08.2016:**

Vide the above amendment rules, a new sub-rule (11) has been inserted in Rule 18 resulting in non-applicability of provisions of such rule to rupee denominated bonds issued exclusively to overseas investors in terms of RBI Circular/guidelines. Click the following link for the complete rules.
http://www.mca.gov.in/Ministry/pdf/CompaniesFourthAmendmentRules_17082016.pdf

❖ **Investor Education and Protection Fund Authority (Appointment of Chairperson and Members, holding of meetings and Provision for offices and officers)Amendment Rules, 2016, Dt:05.09.2016:**

Vide the above amendment rules, a new Rule 3-A, has been inserted, designating the nature of the Authority as prescribed in Rule-3 of the Principal rules. As per the amendment rules, the Authority under Rule-3, shall be a Body Corporate. Click the following link for the complete rules.
http://mca.gov.in/Ministry/pdf/Rules_06092016_1.pdf

❖ **Investor Education and Protection Fund Authority (Accounting, Audit, Transfer and Refund) Rules, 2016, Dt: 05.09.2016, [effective from 07.09.2016].**

Vide the above rules, the ministry has come with a set of rules/procedural aspects, relating to Accounting, Audit and Transfer and refund of the Investor Education and Protection Fund. Click the following link for the complete rules.
http://mca.gov.in/Ministry/pdf/Rules_06092016.pdf

Notifications

❖ **Designation of Special Court for trial of offences under the Act:**

Vide above notification, the Ministry has designated certain courts as the Special Courts for some states, to provide speedy trial of offences punishable with imprisonment of two or more years under Companies Act, 2013. Click the following link for the complete notification.
http://www.mca.gov.in/Ministry/pdf/Notification_05092016.pdf

❖ **Commencement Notification as to certain provisions of Section 124& 125 of the Companies Act, 2013:**

The Central Government has notified that the provisions of Section 124 (1) to (4) & (6) and Section 125 (8) to (11), shall come in to effect from 07.09.2016. Click the following link for the complete notification.
http://mca.gov.in/Ministry/pdf/Notification_06092016.pdf

Circulars

- **General Circular 09/2016, Dt:03/08/2016 - Issuance of Rupee denominated Bonds to overseas investors by Indian Companies:**

Vide the above circular, MCA has clarified the provisions of Chapter III of the Companies Act, 2013 and Rule 18 of the Companies (Share Capital and Debentures) Rules, 2014 shall not be applicable to issue of rupee denominated bonds by Indian companies, exclusively to persons resident outside India. Click the following link for the Circular. **http://mca.gov.in/Ministry/pdf/GeneralCircular09_03082016.pdf**

These updates are contributed by K. Bhavani and vetted by CS D V K Phanindra of SBS and Company LLP, Chartered Accountants. For any queries, please reach at phanindra@sbsandco.com

SA 230 Audit Documentation - A. Sai ram

SA 700 - K. Bhavani

Appointment of Auditor w.r.t Tenure and Compliance - A. Madhuri

5 W's and 1H under CENVAT Credit rules, 2004 - P. Uday Kumar

ICAI Motto song

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Kurnool: No. 302, 3rd Floor, V V Complex, 40/838, R.S. Road, Near SBI Main Branch, Kurnool, Andhra Pradesh
Nellore: 16-6-259, 1st Floor, Near Santi Sweets Opp: SBI ATM, Vijayamahal Centre, SPSR Nellore, Andhra Pradesh
Tada: 8-3-425/2, Flat No. 202, 2nd Floor, Bigsun Avenue, Near SRICITY, TADA, SPSR Nellore Dist, Andhra Pradesh
Visakhapatnam: # 39-20-40/6, Flat No.7, Sai Yasoda Apartments, Madhavadhara,Visakhapatnam (Urban),Vizag, Andhra Pradesh
Bengaluru: B104,RIRCO, Santosh Apartments, Wind Tunnel Road, Murugeshpalya, Old Airport Road, Bangalore – 560017, Karnataka.

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