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THE CHARTERED ACCOUNTANT

JOURNAL OF THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

HAPPY New year 2023

Startups-
Igniting Innovation, Creating Value

ICAI - SET UP BY AN ACT OF PARLIAMENT

Invitation to Write Articles

Chartered Accountants and other subject experts, with academic passion and flair for writing, are invited to share their expertise through the ICAI Journal – *The Chartered Accountant*. The article may cover any topic relevant to the accounting world covering auditing, finance, laws, strategy, taxation, technology and so on. While submitting articles, please keep following aspects in mind:

- The length of articles should be about 2500 words.
- Articles should be original in nature
- An executive summary of about 100 words should accompany the article.
- Articles should not have been published or sent for publishing in any other print or electronic media.

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Visit https://www.icai.org/post.html?post_id=2557 *for detailed guidelines and formats of declaration of originality and assignment of copyright.*

The Institute of Chartered Accountants of India

Editorial

Startups – Igniting Innovation, Creating Value

India's push for entrepreneurship and Startups to promote culture of innovation and value creation, has galvanized Indian economy to become the fastest growing economy globally as per IMF for the years 2022 and 2023 with growth forecast of 6.8% and 6.1% respectively. Over the years, with the reforms driven growth, rise of technology and professional talent, the Indian startup ecosystem has grown rapidly to become the 3rd largest Startup ecosystem globally with over 84,000 recognized startups spread throughout 656 districts. Startups are about pushing the boundaries by putting the knowledge into action to make impact with its creative solutions for the socio-economic development of the nation. Startups have emerged as epicentres fostering creativity and innovations, empowering youth with more career opportunities, more employment leading to a stronger economy as development is across the breadth of nation .

The Government and its constituents with reforms push, strong intellectual and technological acumen, have laid well thought strategy for developing a blueprint for long-term economic development of the nation by tapping the entrepreneurial spirit of the youth power. The Startups are going to be one of the important elements, as it emerges as next growth engine, powering the economic growth. The rise of Startups is very important for the country, as it is the idea factories of future, employment creation, democratizing technology for citizens and boosting competence of the MSMEs and industries through research and development. Therefore, it is paramount to build frameworks for uplifting startups, and make the country the best destination for investments.

The Startups today are talk of the town, but these are built over time with determination, dedication and discipline. Not all the Startups become success, the startup domain has its share of struggles, and we have seen many promising enterprises going down. The Startups are brilliant in innovation but they need professional expertise and guidance in navigating the business milieu, wherein the role of Chartered Accountants as trusted business advisor is important. Today managing cash, fund flows, valuations, setting internal processes, developing strategy are the common challenges being faced by the Startups which need to be resolved for moving ahead in the path of success. This issue covers articles on funding, innovation, valuation, taxation & regulatory aspects and startup ecosystem which shall broaden the perspective of all stakeholders.

As we move on the path to build a resilient and self-reliant economy the role of startups becomes important, to meet the aspirations of all and inspire the entrepreneurial youth. The prowess of startups in harnessing technology for financial inclusion, better education and healthcare for holistic development are applauded across the world. The Government and policy makers are taking measures, structural reforms and initiatives to galvanize the startup economy in the country. The profession has a pivotal role to play with its knowledge and rich experience in this growth journey, by supporting the government in forming effective policies and frameworks, enhance competence and capability of startups and building trustworthy investment climate.

The ICAI and its constituents are building the future economy by developing talent for future which is business and tech savvy and has entrepreneurial spirit to drive innovation and creativity on global landscape. With initiative like the ICAI Start Up programme ICAI aims to coordinate, synergise and leverage various strands of excellence driven innovation and entrepreneurship & wishes to facilitate the creation of ideas and inventions that benefit society. The accounting profession has a deep reach and connects to the MSME sector as SMPs are the trusted financial advisor of MSMEs and startups. The profession understands the pulse of the sector and can provide an able ecosystem for the development of Startups in India.

India has taken over the Presidency of G – 20 which is one of the largest economic forums in the world, with its members accounting for more than 80% of the world's GDP, 75% of global trade and 60% of the world's population. India would be working towards its vision of "One Earth, One Family and One Future" by exploring the power of Startups to ignite innovation-fuelled economic recovery and growth, while building a citizen-centric decentralized governance system which is in alignment with each nation's evolving needs and value system. India would be sharing its learnings and lessons with the Startups in terms of job creation, technological advancement, long-term growth, and crisis management and leverage the same to revitalize the global economy.

India with its initiative, Startup-20 Engagement Group at G20, aspires to help the world develop an inclusive framework to support innovative startups through strategic collaboration across G20 nations. The idea is to create a global narrative for supporting startups and enabling synergies between startups, corporates, investors, innovation agencies and other key ecosystem stakeholders. The opportunity for creating shared value is huge and as a nation we should leverage our intellectual capital to steer the G-20 nations startups agenda.

-Editorial Board ICAI: Partner in Nation Building

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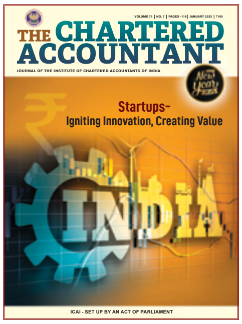

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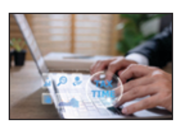

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From the President

CA. (Dr.) Debashis Mitra
President, ICAI

Dear Colleagues,

"If we work and sweat for the great vision with ignited minds, the transformation leading to the birth of vibrant developed India will happen."

- Dr. A.P.J. Abdul Kalam

'World is One Family' or 'Vasudhaiva Kutumbakam' being the true spirit of India's G20 presidency would be an important point in her history as it seeks to play a significant role by finding pragmatic global solutions for the wellbeing of all. In recent years we have emerged not only as a nation which has capabilities of becoming the knowledge hub of the world but also as a country which can become a torch bearer for global changes.

India, with its Startup-20 Engagement Group at G20, aspires to help the world develop an inclusive framework to support innovative start-ups through strategic collaboration across G20 nations and also intends to create a global narrative for supporting startups and enabling synergies between startups, corporates, investors, innovation agencies and other key ecosystem stakeholders.

The Journal theme for the month is Startups as National Startup Day is celebrated on 16th January to commemorate spirit of entrepreneurship and acknowledge the role of Startups as new engine of economic growth strengthening India's position on global stage. Today, India is the 3rd largest startup nation, creating value, generating jobs, attracting FDI and showcasing India's leadership ability. With initiatives like the ICAI Start Up programme, the Institute aims to coordinate, synergise and leverage various strands of excellence driven innovation and entrepreneurship, pushing society forward and attracting investment for stimulating the economy.

Let me share some of the significant professional developments that have taken place since my last communication:

Meeting of Coordination Committee – Ministry of Corporate Affairs

The Meeting of the Coordination Committee of the Three Professional Institutes was held on 7th December, 2022. The meeting was chaired by Dr. Manoj Govil, Secretary, Ministry of Corporate of Affairs, along with officials of the Ministry and attended by myself, CA. Aniket S. Talati Vice President, alongwith the Secretary, ICAI and respective heads of the other two Sister Institutes, i.e., The Institute of Company Secretaries of India and The Institute of Cost Accountants of India. Discussions were held on various areas relating to the profession.

ICAI MSME Yatra recognised in India Book of Records

With Government launching various schemes to strengthen Indian MSMEs, ICAI too, as a true partner-in-nation-building has taken several initiatives to enhance the capacity building measures of MSMEs & Start-ups in India. I am delighted to share that MSME Yatra initiative has been inducted in the prestigious India Book of Records. This feat was achieved, when ICAI conducted MSME programmes in maximum cities during nationwide 'ICAI MSME SETU' and 'ICAI MSME YATRA' campaigns covering 75 cities across 22 States of the nation in 75 days for promoting entrepreneurship as well as to boost job creation and develop the economy. The campaign was held from August 18, 2022 till November 18, 2022.

From the President

I wholeheartedly thank and congratulate ICAI Regional Councils, Branches and other stakeholders who actively participated in this campaign to support MSME ecosystem in the country. ICAI is committed to working towards empowering MSMEs and Start-up sector in the country to boost the economy.

ESG Talk Shows

Moving ahead with its agenda to create awareness and educate the stakeholders about the Sustainability Reporting, the Institute through its Sustainability Reporting Standards Board had conceptualized ESG Talk Shows so that ESG and Sustainability experts can share their real-life experiences. The objective of the ESG Talk Series is to present experts' views on a variety of contemporary ESG/Sustainability topics, including ESG frameworks and regulatory aspects and promote dialogue and give momentum to the sustainability movement in the country.

International Collaboration and Initiatives

The Institute believes that it is important that we undertake regular interaction with our global counterparts and contribute more effectively in global standard setting process. The meetings with our international counterparts are very significant as it helps in the development of the accounting profession globally by identifying the strategic priorities and setting the tone to navigate the future. Following are the developments in this regard:

Pan African Federation of Accountants Board Meeting

I, along with CA. Aniket S. Talati, Vice President, ICAI visited Algeria on 12th December, 2022 to attend the Board Meeting of the Pan African Federation of Accountants (PAFA). The meeting was very beneficial and various issues of relevance to the profession were discussed. The Members of the Board were extremely appreciative of the World Congress.

SAFA Events in Kathmandu, Nepal

SAFA Board Meeting and Function for SAFA Best Presented Annual Report (BPA) Awards, Integrated Reporting Award and South Asian Association for Regional Cooperation (SAARC) Anniversary Award for Corporate Governance were held in Kathmandu, Nepal on 18th December, 2022. ICAI was duly represented in these Meetings.

Engaging with Overseas Chapters

In building and expanding our brand globally, Overseas Chapters play a pivotal role as ambassadors of the Profession.

- *International Conference, Bahrain*

  I, along with CA. Aniket S. Talati, attended the 14th International Conference of Bahrain Chapter of ICAI on 10th December, 2022 on the theme "New Horizon Beckons" and addressed the members of the Chapter. The Conference was well attended and propagated the brand of the Institute.

- *International Seminar, Oman*

  We also attended the 12th International Seminar organized by the Oman (Muscat) Chapter of ICAI on the theme "CA-Success through Synergy". Among those present were Dr. Rahma bint Ibrahim Al Mahrouqiyah, Minister of Higher Education, Research and Innovation, Oman and Mr. Amit Narang, Ambassador of India to the Sultanate of Oman. The event emphasized the significance of strengthening synergies between accounting professionals and various institutions in a fast changing global environment.

- *Annual Conference, Dubai*

  We participated in the Annual Conference of Dubai Chapter of ICAI on 27th November, 2022. The Conference had a gathering of more than 1000 delegates. The recent initiatives of ICAI including the story behind the success of WCOA 2022 and the key learnings for the future were presented before the delegates. Meetings and interactions were also held with Management Committee and Chapter Members and they were assured of full support from the Institute.

Nurturing the Future of Profession

ICAI being a prominent and world class educational institution actively works towards

From the President

expanding the ecosystem for development of Commerce education in the country and to attract the best talent to the profession through Career Counselling, as also build the capacity and competency of the CA students through various interactive initiatives like CA Student Conferences.

- *CA Students International Conference*

  An International Conference for CA Students was organized on the theme "Facing The Future – Innovate, Integrate, Motivate" which was graced by Smt. Dr. Tamilisai Soundararajan, Hon'ble Governor of Telangana & Lt. Governor of Puducherry, as the Chief Guest on 2nd -3rd December, 2022 at Hyderabad. More than 2500 Students registered for the Conference. The two-day event provided an excellent opportunity for the students to exchange ideas and supplement their knowledge through interaction and experience with their foreign counterparts.

- *Mega Career Counselling Programme*

  The second drive of the Super Mega Career Counselling Programme was organized on 26th November, 2022 for Western Region and its branches along with the branches of other regions which could not participate earlier. The students of class IX till Graduation participated in this counselling programme. In this drive, approx. 52,000 students participated along with the Principals, Teachers and Career Counsellors. The programme was organized by 36 branches including Western India Regional Council.

MoU for Knowledge Transfer

The Institute through its Committee on Public and Government Financial Management signed a Memorandum of Understanding (MoU) with the Commissioner of Treasuries and Accounts (CTA), Government of Tamil Nadu (GoTN) for knowledge transfer and skill development of officials of Treasuries, Accounts and Finance Department, GoTN on December 20, 2022 in the august presence of Dr. Palanivel Thiaga Rajan, Hon'ble Minister for Finance and Human Resources Management, GoTN. A plan of action for implementation of MoU has also been prepared. First segment of training as per MoU has commenced from December 22, 2022.

Interactive Meet at Mumbai

The Professional Development Committee conducted an Interactive Meet with Directors, Audit Committee Chairmen, and Members & CFOs of Commercial Banks on 20th December 2022 in Mumbai which was inaugurated by Shri Satish Kashinath Marathe, Hon'ble Director on the Central Board, Reserve Bank of India. The Meet had an overwhelming response and the discussions and insights were very useful.

The Meet had sessions on crucial topics like Sustainability and Green Finance, Audit of Banks and its Governance, and Embracing Digital Transformation in Banks- An Audit Committee's Perspective among others.

Conclusion

As we usher in the New Year, it is the perfect time to assess our progress, think back on our successes and create plans for the year to come.

I am reminded of the essential values of our Constitution, which serve as the cornerstone of the democratic system in our nation, as we prepare to celebrate the 74th Republic Day on 26th January. These values are the ideal inspiration for us to contribute to the development of an inclusive society that values autonomy, integrity, creativity and a forward-thinking mindset.

Our Profession has played an important role in igniting reforms and adding value for the nation's economic development. We take pride in being a Partner in Nation Building.

In the year 2023, may we continue our journey of building Trust and attaining Respect & Dignity for the Profession.

Wishing all of you a Very Happy New Year.

Debashis Mitra

CA. (Dr.) Debashis Mitra
President, ICAI
Kolkata, 27th December, 2022

Photographs

ICAI President CA. (Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati at the 54th Regional Conference of SIRC. Also seen in the picture are Central Council Member CA. Prasanna Kumar D., SIRC Chairman CA. China Masthan T. and other dignitaries. (9th December, 2022)

ICAI President CA. (Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati meeting with Shri Amit Narang, Hon'ble Ambassador of India to Oman. Also seen are Managing Committee Members of the Muscat Chapter of ICAI. (10th December, 2022)

ICAI President CA. (Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati at the 14th Annual International Conference organised by the Bahrain Chapter of ICAI. Also seen in the picture are Managing Committee Members of the Bahrain Chapter of ICAI. (10th December, 2022)

ICAI Vice President CA. Aniket S. Talati inaugurating the CFO Meet in Nagpur. Also seen in the picture are ICAI Past President CA. Jaydeep N Shah and Central Council Members CA. (Dr.) Raj Chawla, CA. Ranjeet Kumar Agarwal and CA. Durgesh Kumar Kabra. (8th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra along with Central Council Members CA. Dayaniwas Sharma and CA. Muppala Sridhar with the students attending Four Week Residencial Program-Hyderabad (25th November, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati at the ICAI TAX Conclave in Ahmedabad. Also seen in the picture are ICAI Past President CA. Sunil Talati and Central Council Member CA. Purushottamlal H. Khandelwal. (17th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra unveiling the Conference Souvenir in the presence of Chief Guest H.E. Sheikh Nahayan Bin Mabarak Al Nahayan, Hon'ble Minister of Tolerance & Coexistence and Shri Sunjay Sudhir, Hon'ble Ambassador of India to UAE at the 40th Annual International Conference at Dubai. (27th November, 2022)

ICAI President CA. (Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati at the Bhoomi Pujan ceremony at Jamnagar. Also seen in the picture are Central Council Members CA. Purushottamlal H Khandelwal, CA. Vishal Doshi, CA. Piyush S Chhajed and CA. Umesh Sharma. (29th November, 2022)

ICAI President CA.(Dr.) Debashis Mitra and Members of the Central Council CA. Durgesh Kumar Kabra, CA. Purushottamlal H Khandelwal, CA. Sushil Kumar Goyal and CA. Piyush S. Chhajed attending the Seminar on Real Estate Transaction & Taxation in Nagpur. (8th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati along with Members of the Central Council in the program for recognition of ICAI in the India Book of Records for the ICAI MSME Yatra. (15th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra, ICAI Vice President CA. Aniket S. Talati along with Members of the Central Council releasing the ICAI Campus Placement Overseas brochure during the Central Council meeting. (15th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati along with Members of the Central Council releasing the booklet on Quick insights on Professional Opportunities for Chartered Accountants during the Central Council meeting. (15th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati attending the 12th International Seminar organised by the Muscat Chapter of ICAI.(10th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra along with Chief Guest Shri Ashok Singhal, Hon'ble Minister Housing and Urban Affairs, Govt. of Assam at National Conference held in Guwahati. Also seen in the picture are Central Council Member CA. Ranjeet Kumar Agarwal and EIRC Chairman Ravi Kumar Patwa and Managing Committee Members of Guwahati Branch. (16th December, 2022)

Meeting of the Coordination Committee was attended by ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati under the Chairmanship of Shri Manoj Govil, Secretary, MCA. Also seen in the picture Shri Manoj Pandey, Joint Secretary, MCA, Shri Inder Deep Singh Dhariwal, Joint Secretary, MCA, the Presidents of two sister institutes and CA.(Dr.) Jai Kumar Batra, Secretary ICAI. (7th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati attending the Board meeting of Pan Africa Federation of Accountants (PAFA) at Algiers, Algeria. (12th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati attending the Members Meet in Rajkot. Also seen in the picture are Central Council Members CA. Purushottamlal H. Khandelwal, CA. Vishal Doshi, CA. Umesh Sharma and CA. Piyush S Chhajed. (29th November, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati felicitating the Chief Guest Dr. Tamilsai Soundararajan, Hon'ble Governor of Telangana & Lt. Governor Puducherry at the Student International Conference–Hyderabad. Also seen in the picture are Central Council Members CA. Sushil Kumar Goyal, CA. Dayaniwas Sharma, SIRC Chairman CA. China Masthan T. and CA. Deepak Ladda, Chairman Hyderabad Branch. (2nd December, 2022)

ICAI Vice President CA. Aniket S. Talati along with Central Council Members CA. Purshottamlal H Khandelwal, CA. Prakash Sharma and CA. Hans Raj Chugh attending the One-Day Orientation Program in Ahmedabad. (26th November, 2022)

Signing of MoU with Govt. of Tamil Nadu. Seen in the picture are ICAI Central Council Members CA. Sripriya K. and CA. Rajendra Kumar P., along with Dr. Palanivel Thiaga Rajan, Hon'ble Minister for Finance and Human Resources Management, GoTN, Thiru. K. Vijayendra Pandian, IAS, Commissioner of Treasuries and Accounts, GoTN and CA.(Dr.) Jai Kumar Batra, Secretary, ICAI (20th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra and ICAI Vice President CA. Aniket S. Talati at the program to celebrate the Success of 21st World Congress of Accountants, 2022 along with the employees in ICAI BKC Mumbai. Also seen in the picture are Central Council members ICAI, CA. Priti Savla, CA. Mangesh P Kinare, CA. Durgesh K Kabra, CA. Kemisha Soni and CA.(Dr.) Sanjeev Kumar Singhal (20th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra being felicitated at the Interactive Meet held at Pune Branch. Also seen in the picture is Central Council member CA. C V Chitale and Past Council member CA. S B Zaware. (20th December, 2022)

ICAI President CA.(Dr.) Debashis Mitra, ICAI Vice President CA. Aniket S. Talati and CA.(Dr.) Jai Kumar Batra, Secretary, ICAI at the program to celebrate the Success of 21st World Congress of Accountants, 2022 along with ICAI employees in New Delhi. (21st December, 2022)

ICAI Vice President CA. Aniket S. Talati inaugurating the Udyati-4 One day Conference at Visakhapatnam. Also seen in the picture are Central Council members CA. Prasanna Kumar D., CA. Piyush Chhajed and SIRC Chairman CA. China Masthan T. (22nd December, 2022)

Group Photograph during the Interactive Meet with Directors, Audit Committee Chairmen & CFOs of Commercial Banks held in Mumbai. Seen in the Picture are ICAI President CA.(Dr.) Debashis Mitra, Chief Guest Shri Satish Marathe, Director, RBI and ICAI Vice President CA. Aniket S. Talati along with ICAI Central Council Members and Independent Directors. (20th December, 2022)

ICAI President CA. (Dr.) Debashis Mitra releasing the souvenir at the 47th Regional Conference, organised by the EIRC of ICAI, Kolkata. Also seen in the picture are ICAI Past President CA. A C Chakrabortti, Central Council member CA. Ranjeet Kumar Agarwal and EIRC Chairman, Ravi Kumar Patwa, Regional Council members of the EIRC and past Chairmen of EIRC. (23rd December, 2022)

Know Your Ethics

1. **Whether a Chartered Accountant who is appointed as tax auditor for conducting special audit under the Income-Tax Act 1961, by the Income Tax Authorities is required to communicate with the statutory auditor?**

A. Yes, Council direction mentioned in Paragraph 2.14.1.8(xiii) under Clause (8) of Part-I of First Schedule to the Chartered Accountants Act, 1949, appearing in Volume II of the Code of Ethics, prescribes that it would be a healthy practice if a tax auditor appointed for conducting special audit under the Income-Tax Act 1961, communicates with the member who has conducted the statutory/tax audit.

2. **Whether communication with the previous auditor is necessary in case of appointment as statutory auditor by nationalized and other Banks?**

A. Yes, Clause (8) of Part-I of the First Schedule to the Chartered Accountants Act, 1949 is equally applicable in the case of nationalized and other Banks and also to Government agencies.

3. **Whether communication by the Incoming auditor is mandatory with the previous auditor in respect of various audit assignments like the concurrent audit, revenue audit, tax audit and internal audits etc.?**

A. Yes, the requirement for communicating with the previous auditor would apply to all types of audits. The Council has laid down detailed guidelines in this regard and the same are appearing in Paragraphs 2.14.1.8(xiv) to 2.14.1.8(xvii) under Clause (8) of Part-I of First Schedule to the Chartered Accountants Act, 1949, appearing in Volume II of the Code of Ethics.

4. **Whether a Chartered Accountant will be deemed to be guilty of professional misconduct if he accepts his appointment as an auditor immediately after intimating his appointment over the phone to the previous auditor?**

A. Yes, the member would be held guilty of professional misconduct for the following reasons:

(a) That he had failed to communicate with the retiring auditor in writing; and

(b) That he did not wait for a reasonable length of time for a reply to be received from him.

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Know Your Ethics

5. Whether a Chartered Accountant can accept an appointment as auditor of a company without first ascertaining from it whether the requirements of the Companies Act, in respect of such appointment have been duly complied with?

A. No, as per Clause (9) of Part-I of the First Schedule to the Chartered Accountants Act, 1949, a Chartered Accountant in practice shall be deemed to be guilty of professional misconduct if he accepts an appointment as auditor of a company without first ascertaining from it whether the requirements of Section 225 of the Companies Act, 1956 (sections 139 and 140 of Companies Act, 2013) in respect of such appointment have been duly complied with. In this regard, the Council has laid down detailed guidelines that are appearing in Paragraphs 2.14.1.9(ii) to 2.14.1.9(xxxix) under Clause (9) of Part-I of the First Schedule to the Chartered Accountants Act,1949, appearing in Volume II of the Code of Ethics.

6. Whether a statutory auditor of a company can be appointed in the adjourned meeting in place of existing statutory auditor where no special notice for removal or replacement of the retiring auditor is received at the time of the original meeting?

A. No, if any annual general meeting is adjourned without appointing an auditor, no special notice for removal or replacement of the retiring auditor received after the adjournment can be taken note of and acted upon by the Company, since in terms of Section 115 of the Companies Act, 2013, special notice should be given to the Company at least fourteen clear days before the meeting in which the subject matter of the notice is to be considered. The meeting contemplated in Section 115 undoubtedly is the original meeting. Where at any annual general meeting, no auditor is appointed or re-appointed, the existing auditor shall continue to be the auditor of the company mentioned in Section 139.

7. Whether a Chartered Accountant or a Firm of Chartered Accountants can charge or offer to charge professional fees based on a percentage of turnovers?

A. No, in terms of Clause (10) of Part I of First Schedule to the Chartered Accountants Act, 1949, it is not permitted to a Chartered Accountant or a firm of Chartered Accountants to charge fees on a percentage of turnover, except in the circumstances provided under Regulation 192 of the Chartered Accountants Regulations, 1988.

"192. Restriction on fees No Chartered Accountant in practice shall charge or offer to charge, accept or offer to accept, in respect of any professional work, fees which are based on a percentage of profits, or which are contingent upon the findings, or results of such work: Provided that:

(a) in the case of a receiver or a liquidator, the fees may be based on a percentage of the realization or disbursement of the assets;

(b) in the case of an auditor or a co-operative society, the fees may be based on a percentage of the paid up capital or the working capital or the gross or net income or profits; and

(c) in the case of a valuer for the purposes of direct taxes and duties, the fees may be based on a percentage of the value of the property valued.

(d) in the case of certain management consultancy services as may be decided by the resolution of the Council from time to time, the fees may be based on percentage basis which may be contingent upon the findings, or results of such work;

(e) in the case of certain fund raising services, the fees may be based on a percentage of the fund raised;

(f) in the case of debt recovery services, the fees may be based on a percentage of the debt recovered;

(g) in the case of services related to cost optimisation, the fees may be based on a percentage of the benefit derived; and

(h) any other service or audit as may be decided by the Council.

Note: Following activities have been decided by the Council under "h" above :-

Know Your Ethics

(i) Acting as Insolvency Professional

(ii) Non-Assurance Services to Non-Audit Clients.

8. Whether a Chartered Accountant in practice can engage in any business or occupation other than the profession of Chartered Accountancy?

A. No, in terms of Clause (11) of Part- I of First Schedule to the Chartered Accountants Act, 1949, in general a Chartered Accountant in practice is not permitted to engage himself in any business or occupation other than the profession of Chartered Accountants.

However, there are the following exceptions to it:

(i) A Chartered Accountant can be the Director of a Company (not being a Managing Director or Whole-Time Director), unless he or any of his partners is interested in such company as an auditor. [Proviso to Clause (11)]

(ii) A Chartered Accountant in practice may engage in any business or occupation with the permission granted in accordance with a resolution of the Council (Regulation 190A).

Appendix (9) of the Chartered Accountants Regulations, 1988 contains the said resolutions under two heads (A) permission granted generally and (B) permission to be granted specifically.

9. Whether a member in practice is allowed to become a whole-time director of a company?

A. No, members are not allowed to become whole-time Directors of a company generally. However, a member in practice may become a Managing director or a whole-time Director of a body corporate subject to the Council Guidelines of Corporate Form of practice.

10. Whether a member in practice can be a Director Simplicitor of a company?

A. Yes, a member in practice is permitted generally to be a Director Simplicitor in a company provided he is not a Managing Director or Wholetime Director and is required only in the Board Meetings of the company and not paid any remuneration except for attending such meetings. Specific permission of the council is not required in this regard.

11. Whether a member in practice, who is a resident director, in terms of the provisions of Section 149(3) of the Companies Act, 2013, is covered under the scope of "Director Simplicitor"?

A. A Director, as contemplated within the provisions of Section 149(3) of the Companies Act, 2013, would be within the scope of Director Simplicitor provided, he is a non-executive director required to attend the Board Meetings only, and not paid any remuneration except for attending such Board Meetings.

12. Whether a Chartered Accountant in practice is entitled to accept teaching assignment?

A. Yes, a Chartered accountant in practice is allowed to accept teaching assignment in university, affiliated colleges, educational institution, coaching organization, private tutorship, provided that for the purpose of entitlement to attest functions the direct teaching hours devoted to such activities taken together do not exceed 25 hours a week.

13. Can a Chartered Accountant working in a Firm of Chartered Accountants hold Certificate of Practice?

A. Yes, a chartered Accountant working in a Firm of Chartered Accountants can hold Certificate of Practice. However, he is not entitled to do any attest function.

14. Whether a member in practice take license of investment advisor (as required by SEBI to provide service of Investment advice) and provide the service as an Investment advisor and other attestation services?

A. Member in practice is allowed to take license/ registration of investment advisors from SEBI. However, the member is not allowed to engage in the service of broking, underwriting and cannot take agency of mutual funds etc.

Opinion

Classification of PPE under refurbishment, depreciation thereon and its impairment

A. Facts of the Case

1. A Company (hereinafter referred to as 'the Company') is a Central Public Sector Undertaking in India under the administrative control of the Department of Fertilizers, Ministry of Chemicals and Fertilizers. The Company was incorporated in December 1966 as a joint venture between the Government of India (GOI) and ABC India Incorporation of USA with the GOI holding 51% of the equity share capital. The Company is engaged in the manufacture of ammonia, urea and complex fertilizers.

2. The production units of the Company consist of Ammonia and Urea in single stream and Nitrogen, Phosphorus and Potassium (NPK) in three streams, viz. NPK A Train, B Train and C Train. The Company has commenced its commercial production in 1971, with an annual installed capacity of 2,47,500 Metric Tonnes (MT) of Ammonia, 2,92,050 MT of Urea and 5,40,000 MT of NPK. A major revamp/expansion was carried out in 1998 at a cost of ₹ 601 crore, enhancing the annual installed capacity to 3,46,500 MT of Ammonia, 4,86,750 MT of Urea and 8,40,000 MT of NPK.

3. The querist has stated that NPK A, B and C trains of the Company have an installed capacity of 2.8 lakh Metric Tonnes per Annum (MTPA) each. NPK A and B trains which have an installed capacity of 5.6 lakh MTPA are not in operation from 2005 (i.e., more than 15 years) due to technical issues, non-availability of raw materials and shortage of manpower. Currently, they are not in immediate use condition due to technical obsolescence arising from change in the production process.

4. As per the Company's accounting policies, the estimated useful life of plant and machinery is 25 years. Post-revamp, the NPK A and B trains are used hardly for 7 years and thereafter they became idle. Accordingly, the Board of Directors of the Company at 314th Board meeting held on 09th November 2020, has made the revision of the installed capacity of NPK A, B and C from 8.4 lakh MTPA to 2.8 lakh MTPA, by making a note as under:

> "Further, both the trains of A & B are not in line for more than 15 years and are not in immediate use condition. Hence until these trains are revived for usability, it is proposed to revise the Installed Capacity of NPK Complex from 8.4 lakh MTPA to 2.8 lakh MTPA taking into account only the Train C which is in operation."

5. The querist has further stated that the Company has a plan of refurbishing the NPK A and B trains in order to bring the viability of the said trains. In the financial statements of the Company for the year ended 31st March 2021, consequent to the Board approval, the Company has withdrawn the assets belonging to NPK A and B trains from the Property, Plant and Equipment (PPE) with effect from 01st April 2020 and classified under Capital work in progress (CWIP). The same will be re-inducted to PPE once these are refurbished and in ready-to-use condition.

Due to classification of the assets of NPK A and B train from PPE to CWIP, the Company has ceased the depreciation of the said assets from 01st April 2020 onwards.

The carrying cost of assets in the NPK A and B trains as on 31st March, 2020 is Rs. 2.22 crore, which has been classified as CWIP in the financial statements of the Company for the year ended 31st March 2021.

6. During the audit of annual accounts of the Company for the financial year (F.Y.) 2020-21, the Comptroller and Auditor General of India (C&AG) has made a provisional comment on the said classification, which is reproduced below:

> "1.5 Assets- Property Plant and Equipment – Rs. 188.39 crore
>
> Reference is invited to Note No. 30.6 attached to and forming part of Standalone Ind AS Financial Statements for the year 2020-21, wherein it was stated that the Company removed Trains A and B of NPK plant from 'Property Plant and Equipment' as the assets are not in operation since 2005. The Board of Directors in their 314th Meeting held on 9th November 2020, revised the installed capacity of NPK plant from 8.40 lakh MT per annum to 2.80 lakh MT per annum until these trains are revived for usability. On the basis of the above Board decision dated 9th November 2020, the carrying cost (Net Assets Value) of these assets as of 01.04.2020 (Rs. 2.22 crore) is reclassified under 'Capital Works in Progress' and therefore the Company did not provide for depreciation on the assets during 2020-21.

According to Indian Accounting Standard (Ind AS) 16, depreciation does not cease when an asset is idle or retired from use for sale (unless it is fully depreciated). (Taxmann Students' Guide to Ind AS 6th Edition). Further, there is no provision in Ind AS to transfer a PPE to CWIP. As such, transferring the Trains A and B of NPK plant to CWIP and failure to provide depreciation is in contradiction to Ind AS.

This has resulted in understatement of Property, Plant and Equipment by Rs. 1.46 crore and understatement of depreciation by Rs. 0.76 crore with corresponding overstatement of capital work in progress by Rs. 2.22 crores."

Reply to C&AG by Company:

7. The reply of the Company as submitted to the C&AG is as under:

"The Board of Directors in their 314th Board Meeting revised the installed capacity of NPK production from 8.40 lakh MTPA to 2.80 lakh MTPA by withdrawing NPK A & B Plant from operation.

Further it is decided to operate the NPK A & B Train after refurbishing.

Ind AS is not specifically mentioning any accounting treatment for transfer from PPE to CWIP.

NPK A and B Plant is withdrawn from operation temporarily, hence, the same cannot be classified under PPE. Further, the assets are not scrapped, only withdrawn for refurbishment and subsequent use. The refurbishment expenditures are in capital nature. Hence the withdrawn assets are reclassified as CWIP.

The NPK A and B Plant was not in use since 2005 and hence was transferred to CWIP during the year and hence it was decided not to provide depreciation during the year."

Reply by the Statutory Auditors of the Company:

8. Further, the statutory auditors of the Company have supplemented the reply made by the Company which is as follows:

"To Supplement, attention is invited to paragraph 67 of Ind AS 16, which states that the carrying amount of an item of property, plant and equipment shall be derecognised either on disposal or when no future economic benefits are expected from its use or disposal. Accordingly, the two assets namely NPK A & B Trains are not in active use since 2005 and no economic benefits accrue to the Company. These are therefore rightly removed from the PPE.

As per Ind AS 105, 'Non-Current Assets Held for Sale and Discontinued Operations', the carrying amount of property, plant and equipment retired from active use is to be classified as held for sale only when the intention of the management is to dispose of the assets within the stipulated time schedule. But it is clear from the resolution passed in their 314th Board Meeting held on 9th November, 2020 that the management has decided to revive the assets for usability. Since the intention is not to sell, grouping under 'Assets Held for Sale' does not arise.

In the absence of any specific date adopted by the Board for reclassification of the asset, it was presumed that the de-recognition of NPK train A & B and depreciation thereon will cease from 01st April 2020, due to non-operation of said trains since 2005 onwards.

Being non-current assets, Ind AS 1, 'Presentation of Financial Statements' permits grouping under alternative description as long as the intention of the management is clear. Paragraph 67 of Ind AS 1 is reproduced below for ready reference:

"67 This Standard uses the term 'non-current' to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear."

In view of above, the classification done by the Company as permitted by Ind AS 1 is more appropriate and justified."

9. The C&AG has not dropped the observation based on reply submitted by the Company and statutory auditors. They retained the comment under section 143(6)(b) of the Companies Act, 2013 on the accounts of the Company for the year ending 31st March 2021, which is as reproduced below:

"A. Comments on Financial Position:

Assets

Capital Work in Progress : Rs. 17.78 Cr. (Note-2.2)

The above includes an amount of Rs. 2.22 crore being the net carrying value of Train 'A' and 'B' of NPK Plant due to derecognition of these assets from 'Property, Plant and Equipment (Note-2)'. These assets were not in operation since the year 2005. These assets were not scrapped and were only withdrawn for refurbishment and subsequent use. No depreciation was charged by the Company on these assets during 2020-21. Company revised the installed capacity of NPK Plant from 8.40 lakh MT per annum to 2.80 lakh MT per annum until these trains of NPK Plant are revived for usability.

Ind AS 16 states that depreciation does not cease when an asset is idle or retired from active use unless the asset is fully depreciated. Further, other factors such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefit that might have been obtained from the asset. Thus, the de-recognition of assets from 'Property, Plant and Equipment' and accounting these under 'Capital Work in Progress' and non-provision of depreciation on such assets, is not in compliance to provisions of Ind AS.

This has resulted in understatement of net carrying value of 'Property, Plant and Equipment' by Rs. 1.46 crore, understatement of 'Depreciation' for the year by Rs. 0.76 crore with corresponding overstatement of 'Capital Work in Progress' by Rs. 2.22 crore. "

B. Query

10. On the basis of the above, the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) has been sought by the querist on the following issues:

(i) Whether accounting treatment followed by the Company with reference to classification from PPE to CWIP and cessation of depreciation is correct and in accordance with Ind AS.

(ii) In case the accounting treatment followed by the Company is correct, then how the presentation of CWIP is to be made in accordance with Schedule III to the Companies Act, 2013, as amended by MCA Notification dated 24th March 2021?

(iii) In case the assets are to be shown under PPE, whether impairment is to be recognised.

C. Points considered by the Committee

11. The Committee notes that the basic issue raised in the query relates to classification of PPE under refurbishment, depreciation thereon and its impairment. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting for refurbishment, appropriateness of the accounting done at the time of major revamp/expansion carried out in 1998, appropriateness of the estimation of the useful life of PPE and other aspects of depreciation, detailed aspects of impairment, accounting adjustments on transition to Ind ASs, accounting for the adjustments (if any) as per the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' etc. The Committee wishes to point out that the opinion expressed hereinafter is in the context of Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015 as amended from time to time.

12. The Committee notes from the Facts of the Case that the querist has stated that NPK A and B plants/trains are not in operation for more than 15 years due to technical issues, non-availability of raw materials and shortage of manpower; and currently, are not in immediate use condition due to technical obsolesce arising from change in production process. The Company now, has a plan of refurbishing the NPK A and B trains in order to bring the viability of the said trains. Therefore, the Company has withdrawn the assets belonging to NPK A and B trains from the Property, Plant and Equipment (PPE) with effect from 01st April 2020 and classified under Capital work in progress (CWIP). As per the querist, the same will be re-inducted to PPE once these are refurbished and in ready to use condition. Further, due to classification of the assets of NPK A and B train from PPE to CWIP, the Company has ceased the depreciation of the said assets from 01st April 2020 onwards.

13. At the outset, the Committee notes that a non-current asset is to be classified as held for sale as per Ind AS 105, if its carrying amount will be recovered principally through a sale transaction

rather than through continuing use. Therefore, NPK A and B plants, whose carrying amount shall be recovered through continuing use although after refurbishment, cannot be considered as non-current assets (or disposal group) held for sale and accordingly, the requirements of Ind AS 105 are not applicable in the extant case.

14. Further, the refurbishment cost on the existing plants, being in the nature of subsequent cost/ expenditure, the Committee notes the following requirements of Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment', in respect of subsequent costs:

"10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. The cost of an item of property, plant and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment, such as depreciation of right-of-use assets."

"Subsequent costs

12 Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables, and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment.

13 Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67–72).

14 A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed."

From the above, the Committee notes that in case of subsequent expenditure involving replacement or major inspections/servicing/repair of an item of PPE, where such subsequent expenditure meets the recognition principle in paragraph 7 of Ind AS 16, the Standard only requires to derecognise the carrying amount of previous inspection cost or existing item or part of PPE being replaced or as per the requirements of paragraphs 67 to 72 and nowhere requires to transfer or classify such an item of PPE on which subsequent expenditure is being incurred as 'capital work in progress' or any other classification.

15. The Committee further notes the following paragraphs of Ind AS 16 relating to derecognition of PPE:

"67 The carrying amount of an item of property, plant and equipment shall be derecognised:

(a) **on disposal; or**

(b) **when no future economic benefits are expected from its use or disposal.**

68 **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless Ind AS 116, *Leases*, requires otherwise on a sale and leaseback). Gains shall not be classified as revenue."**

"69 The disposal of an item of property, plant and equipment may occur in a variety of ways (eg by sale, by entering into a finance lease or by donation). The date of disposal of an item of property, plant and equipment is the date the recipient obtains control of that item in accordance with the requirements for determining when a performance obligation is satisfied in Ind AS 115. Ind AS 116 applies to disposal by a sale and leaseback."

From the above, the Committee notes that an item of PPE shall be derecognised only on disposal or when no future economic benefits are expected from its use or disposal. However, in the extant case, the Company intends to re-induct the plants after refurbishment and thus, it cannot be considered that no future economic benefits are expected from their use (though after refurbishment only). Further, since there is no disposal of the plants, the Committee is of the view that the said items of PPE cannot be derecognised and these should continue to be recognised as PPE in the financial statements.

16. With regard to cessation of depreciation, the Committee notes the following paragraphs from Ind AS 16:

"55 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105 and the date that the asset is derecognised. *Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated.* However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

(Emphasis supplied by the Committee.)

56 The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

(a) expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases."

From the above, the Committee notes that considering that Ind AS 105 is not applicable in the extant case, as discussed above, depreciation of the plants should cease only on the date the plants are derecognised. However, since derecognition conditions as per Ind AS 16 are not fulfilled in the extant case, the depreciation on this ground also should not cease. This is also supported by the requirements of paragraph 55 of Ind AS 16, which specifically states that *depreciation does not cease when the asset becomes idle or is retired from active use, (which appears to be the situation in the extant case) unless the asset is fully depreciated.* Further, the Standard also states that technical or commercial obsolescence and wear and tear while an asset remains idle, also result in the diminution of the economic benefits and useful life of an asset and therefore, depreciation should be provided considering these factors as well.

17. With regard to impairment, the Committee notes the following requirements of Ind AS 16 and Ind AS 36, 'Impairment of Assets':

Ind AS 16

"Impairment

63 To determine whether an item of property, plant and equipment is impaired, an entity applies Ind AS 36, *Impairment of Assets*. That Standard explains how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss."

Ind AS 36

"9 An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

"12 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

…

(e) evidence is available of obsolescence or physical damage of an asset.

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite.[1]

…"

"17 If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognised for the asset."

The Committee notes that Ind AS 36 does not make any exception for the asset being idle or retired from active use. Further, availability of evidence of any obsolescence or the asset becoming idle or plans to restructure provide an indication of impairment. Since in the extant case, the assets (NPK A & B plants/trains) are not in operation for more than 15 years due to various technical issues and are not in immediate use condition due to technical obsolescence arising from change in the production process, the Committee is of the view that these provide indication that these assets may be impaired. Therefore, the same should be assessed by the Company for impairment of assets, as per the requirements of Ind AS 36. Further, these factors may also provide an indication of revision of useful lives of these assets, determined as per the requirements of Ind AS 16.

D. Opinion

18. On the basis of above, the Committee is of the following opinion on the issues raised in paragraph 10 above:

(i) The accounting treatment followed by the Company with regard to classification of PPE under refurbishment as CWIP and cessation of depreciation is not correct as discussed in paragraphs 13 to 16 above.

(ii) In view of (i) above, answer to this question does not arise.

(iii) Since in the extant case, the assets (NPK A & B plants/trains) are not in operation for more than 15 years due to various technical issues and are not in immediate use condition due to technical obsolescence arising from change in the production process, these provide indication that these assets may be impaired. Therefore, the same should be assessed by the Company for impairment of assets, as per the requirements of Ind AS 36, as discussed in paragraph 17 above.

1.	The Opinion is only that of the Expert Advisory Committee and does not necessarily represent the Opinion of the Council of the Institute.
2.	The Opinion is based on the facts supplied and in the specific circumstances of the querist. The Committee finalised the Opinion on July 15, 2022. The Opinion must, therefore, be read in the light of any amendments and/or other developments subsequent to the issuance of Opinion by the Committee.
3.	The Compendium of Opinions containing the Opinions of Expert Advisory Committee has been published in forty-one volumes. These volumes are available for sale and can be procured online through CDS Portal at https://icai-cds.org/.
4.	Recent opinions of the Committee are available on the website of the Institute under the head 'Resources'.
5.	Opinions can be obtained from EAC as per its Advisory Service Rules which are available on the website of the ICAI, under the head 'Resources'. For further information, write to eac@icai.in.

[1] Once an asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale), it is excluded from the scope of this Standard and is accounted for in accordance with Ind AS 105, *Non-current Assets Held for Sale and Discontinued Operations.*

Startups in India: The engines of innovation, the drivers of a revolution

A brief study of the entrepreneurial ecosystem from 2015 – 2022.

***Aastha Grover and **Radhika Kohli**

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The Indian startup ecosystem has been central to the country's growth story in the last few years and especially in the re-emergence of the economy post -pandemic. With Indian unicorns crossing a century in May 2022 and more than 85,000 startups being recognized by DPIIT (Department of Promotion of Industry and Internal Trade) as of date, the Indian startup ecosystem has come of age and is now considered the third largest in the world.

The citizens of the country are rapidly turning to entrepreneurship is a fact well established, but what often goes unrecognised are the continued and focussed engagements undertaken by the Government to support and promote this ecosystem. To catalyse a strong startup culture and build an inclusive ecosystem for innovation and entrepreneurship in India, **Startup India** was launched on 16th January 2016, as a flagship initiative of the Government of India by Prime Minister Shri Narendra Modi. Department for Promotion of Industry and Internal Trade (DPIIT) acts as the nodal Department for the Startup ecosystem.

To holistically understand the ecosystem overview, it is important to draw a relative analysis. And in the case of this ecosystem, a good starting point could be 2015, right before Startup India, the Government of India's flagship initiative was launched. Over the last 7 years, and counting, the entrepreneurial wave in India has witnessed sector-agnostic growth. To begin with, from 448 DPIIT registered startups to 85,000+ today, there is at least one startup in over 662 districts in India, a massive jump from 120 districts in 2015. From approximately 44,000 to 7.8 lac + job opportunities, from 8 to 108 unicorns, from 4 to 31 state policies, the growth of the Indian entrepreneurial ecosystem in these seven years has witnessed a rise of unprecedented magnitude. To break it down further, 1,73,103 jobs alone were created from April 2022 to November 2022 – establishing the robust role of startups in making India a nation of job providers rather than job seekers.

What makes this journey one for the books is the very nature of it, in terms of how inclusive, sector agnostic and disruptive it has been. The last few years have shown some interesting trends in the ecosystem, which may also throw light on the future of this industry. In 2017, 29.5% of all start-ups registered with DPIIT (Department for Promotion of Industry and Internal Trade), Ministry of Commerce and Industry, Govt. Of India had at least one-woman director. As of November 2022, the same percentage has exponentially increased to 47%. 38,620+ startups in the country are proudly led by women – creating over 390,000 + jobs across the length and breadth of India. This remarkable feat is a collective result of government initiatives and dedicated policies to promote women entrepreneurs and make them stand on par with the world.

Ever since its establishment, the Startup India initiative has strived to provide DPIIT recognized startups with a host of support, through tax benefits, ease of procurement, funding opportunities, regulatory support, industry connections, mentorship opportunities and a wide network of international bridges for market access. The initiative also has been pivotal in providing patent benefits to startups, fast-tracking patent applications and providing rebates. In an endeavour to provide the necessary monetary support for startups, DPIIT has a Fund of Funds Scheme which is operated through SIDBI (Small Industries Development Bank of India), with a corpus of INR 10,000 crore. In addition to this, specifically focussed on early-stage startups who find difficulty in accessing capital during the preliminary stages of the startups, the Startup India Seed Fund Scheme was announced by Prime Minister Shri Narendra Modi on 16th January 2021. The scheme was officially launched by Shri Piyush Goyal, Minister of Railways, Commerce & Industry, Consumer Affairs and Food & Public Distribution, on 19th April 2021. The scheme with an overlay of INR 945 crore aims to impact 3600 startups through 300 incubators over the next 4 years.

> **Startups in India are spread over 56 industries, with the top 5 being IT services, Healthcare & Lifesciences, Professional & Commercial Services, Education, and Agriculture.**

In terms of how holistic the overall growth has been, startups in India are spread over 56 industries, with the top 5 being IT services, Healthcare & Lifesciences, Professional & Commercial Services, Education, and Agriculture. As of November 2022, 31 states have their respective startup policy and 53 regulatory reforms have taken place to ease regulatory constrictions, promote Ease of Doing Business and mobilize domestic capital in the startup ecosystem. The spread of this wave across emerging cities (tier 2 and 3) is also testimony to the limitless potential of entrepreneurship at present. 47% percent of startups are from the emerging cities in India and cover at least 56 industries. In the North-East belt, the ecosystem is in an early but transformative stage where all 8 State Governments are working proactively to support startups and their stakeholders to boost wealth and employment generation. Currently, there are more than 850 startups in the Northeast region recognized by DPIIT that have created more than 8,000 job opportunities.

India's revolutionary unicorn story is a triumph well known, and with the count crossing a century in 2022, India is officially the third-largest unicorn nation in the world. As of November 2022, the 107 unicorns in India, with a valuation of over USD 240.79 Billion, have generated more than 2.84 billion job opportunities. Out of these 107 unicorns, 20 have been founded by female entrepreneurs. As time progresses, their rate of growth has only complimented the exponential rise of the overall ecosystem's growth.

Increased digital penetration has undoubtably acted as a major driving force for this growth. The vast gap in technology accessibility in rural and urban India has always functioned as a core opportunity for startups and the past few years have witness Indian startups assuming a key role in bridging this gap along with creating value for all stakeholders in the meantime. More recently, this digital adoption skyrocketed during the pandemic, which further catalysed funding and promotion of digital-savvy businesses as startups increased their geographic footprint exponentially.

> **India's revolutionary unicorn story is a triumph well known, and with the count crossing a century in 2022, India is officially the third-largest unicorn nation in the world.**

Apart from the DPIIT led initiatives, several programs have been launched to propagate a culture of entrepreneurship and provide a host of benefits and opportunities. For e.g., the **Atal Innovation Mission (AIM),** launched in 2016, works towards propagating a culture of entrepreneurship and provides many benefits, including incubation and mentorship support, and international networking opportunities. **ASPIRE (A Scheme for Promotion of Innovation, Rural Industries and Entrepreneurship)**, is a Ministry of MSME-led initiative that aims to create employment opportunities through entrepreneurship in rural areas by setting up incubation centers and a network of technology centers – Technology Business Incubators and Livelihood Incubation Centre with a special focus on the agro-industry.

Under the aegis of The Ministry of Electronics and Information Technology (MeitY), **MeitY Startup Hub (MSH)** has been set up to function as a coordination, facilitation and monitoring centre that integrates and promotes incubation centres, startups and innovation-related activities. Over the years, MeitY has launched schemes to support startups, in terms of funding, IPR, patent filing, export-import mechanisms, and much more.

"Apart from the DPIIT led initiatives, several programs have been launched to propagate a culture of entrepreneurship and provide a host of benefits and opportunities."

As a nodal department to advance technological development in the country, the **Department of Science and Technology (DST)** led cash-benefit schemes to provide grants, technical guidance, and mentoring to individual innovators and startups. DST has also initiated several programs to support the development of innovation centres and scientific research in areas of engineering, biotechnology, communication development and much more. Apart from these initiatives, a host of other marquee programs of the Central and State government have accelerated and boosted the pace of growth for startups via multiple mentorships, funding, networking, and regulatory support mechanisms. DST-NIDHI's **(PRAYAS) PRomoting and Accelerating Young and ASpiring technology entrepreneurs** is another program designed to support young innovators to turn their ideas (knowledge based and technology driven) into viable products. It comes under the umbrella of National Initiative for Developing and Harnessing Innovations (NIDHI), which is conceived and developed by the Innovation & Entrepreneurship division, Department of Science & Technology, Government of India and includes six other key components.

In terms of sector-specific support extended by the government, several notable programs and initiatives have been launched that are championing the startup ecosystem in India. For the agriculture sector exclusively, a host of government-backed programs have been championing the ecosystem for startups, some of which are Yojana-Remunerative Approaches for Agriculture and Allied Sector Rejuvenation (RKVY-RAFTAAR), Small Farmers Agribusiness Consortium (SFAC), Promotion of innovation by Indian Council of Agricultural Research (ICAR), Unleashing Potentials in Agriculture for Young Agripreneurs (UPAYA) by ICAR and National Bank for Agriculture and Rural Development (NABARD) – Nabventures.

In the Animal Husbandry, Dairying and Fisheries sector, a host of schemes have been initiated to promote development and growth for both small and big scale startups. For e.g., Animal Husbandry Infrastructure Development Fund, Dairy Entrepreneurship Development Scheme (DEDS), Dairy Processing & Infrastructure Development Fund, Pradhan Mantri Matsya Sampada Yojana, and National Livestock Mission. And truly adhering to promoting sector-agnostic growth, the government has been dedicated to launching sector-oriented schemes in dynamic and upcoming sectors – for e.g., Biotechnology Ignition Scheme (BIG), Biotechnology Industry Partnership Programme (BIPP) and Small Business Innovation Research Initiative (SBIRI) fence, and space-oriented programmes such as Technology Development Fund, to name a few.

As we envision India 2.0, and strive towards becoming a developed nation, we need to unite and come together to tap into one of the most remarkable and valuable resources our nation has – our entrepreneurs. However, the journey ahead requires an inclusive and sustainable outlook where stakeholders from across states, age groups, ethnicities and gender are given an equitable opportunity. Along with the Government's support and the collective efforts of our innovators, the country's entrepreneurial ecosystem is a solid pillar of the Atmanirbhar Bharat and has the potential to grow at an exponential rate. And the journey of the revolution has only begun.

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Startups in India - Tax and Regulatory Insight

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India is home to the 3rd largest eco-system for startups in the world. With a tough economic period that the world and India has traversed, the moment for our startups to shine is here !, turning this time into an opportunity can be the best outcome for our startups.

Business is gaining buoyancy and with increasing *aatma-nirbhar* markets, the questions is whether Indian Startups are equipped with an accommodative, flexible and easy tax and regulatory landscape to take on this new challenge and deliver for India in its next *"tech-ade"*

Defining "Eligible Startup" / "DPIIT Recognised Startup"

A Startup is an "Entity" fulfilling the conditions as laid down in the Notification[1] issued by Department for Promotion of Industry and Internal Trade (DPIIT) as under Entity is incorporated as a Private Limited Company or Limited Liability Partnership (LLP) or Registered as a Partnership Firm in India and satisfies following 3 conditions:

(a) Less than ten years from the date of its incorporation/ registration

(b) Turnover[2] of the Entity for any of the financial years since incorporation/ registration has not exceeded one hundred crore rupees (INR 100 Crore).

(c) Entity is working towards innovation, development or improvement of products or processes or services, or if it is a scalable business model with a high potential of employment generation or wealth creation

Note: A startup ceases to be an Eligible Startup if does not fulfill the above the criteria or the startup is an entity formed by splitting up or reconstruction of a business already in existence

Process for Registration as an "Eligible Startup" / "DPIIT Recognised Startup"

1. Register on www.startupindia.gov.in as "Startup"
2. Initiate an application for recognition as an "Eligible Startup" on the portal
3. Submit a write up about the nature of business highlighting how it is working towards innovation, development or improvement of products or services or scalability in terms of employment generation or wealth creation.
4. Submit the online application along with Certificate of Incorporation and with other relevant details as required in the application
5. Receive DIPP Recognition Certificate over the registered e-mail ID or rejection of recognition by providing reasons therein

As on 15th December 2022, 85,769 startups have been given "Eligible Startup" recognition by DPIIT

Further guidelines have been issued for recognition of startups on 5th July 2021. Startups and professionals are advised to refer to these guidelines in addition to the above

Income Tax, Regulatory and Other Benefits to an "Eligible Startup"

I. Income Tax Benefits

1. Angel Tax Exemption [Section 56 (2)(viib)] [1]

[1] *Notification No. G.S.R. 127 (E) dated 19.02.2019 issued by Department for Promotion of Industry and Internal Trade (DPIIT)*

[2] *"Turnover" shall have the meaning as assigned to it in clause (91) Section 2 of the Companies Act, 2013;*

"Angel Tax" is a term coined for tax proposed to be levied on consideration received by privately held companies (including startups in particular) towards issue of shares for a value that exceeds the face value of such shares (called "Securities Premium" or "Premium") and where such value i.e. essentially the premium on the shares cannot be justified.

The Central Board of Direct Taxes (CBDT) via intimation over email provides for exemption from the provisions of clause 56(2)(viib), if Eligible Startup upto the following amount :

"aggregate amount of paid up share capital and share premium of the Eligible Startup after issue or proposed issue of share, if any, does not exceed, twenty-five crore rupees (INR 25 Crores)"

In computing the aggregate amount of twenty-five crore rupees shares issued to following persons shall not be included:

a) non-resident or

b) venture capital company or a venture capital fund or

c) "specified company" means a company whose shares are frequently traded[3] and

   i. whose net worth on the last date of financial year preceding the year in which shares are issued exceeds one hundred crore rupees (INR 100 Crores) or

   ii. turnover for the financial year preceding the year in which shares are issued exceeds two hundred fifty crore rupees (INR 250 Crores).

Process for obtaining "Angel Tax Exemption"

The Eligible Startup can avail the exemption under Sec 56 (2)(viib) by following the below steps:

1. Obtain DPIIT Recognition as detailed above
2. Provide relevant self-declaration in Form-2
3. Receive Angel Tax Exemption Letter over the registered e-mail ID

As on February 2021, 3,625 startups have been given "Angel Tax Exemption" recognition by CBDT

Clarification with respect to assessment of Startup Companies involving application of Section 56(2)(viib)

The Central Board of Direct Taxes (CBDT) issued circular[4] requiring assessing officers to purse proceedings / inquiries under section 56(2)(viib) of Income Tax Act for "limited scrutiny" or "complete scrutiny" in the case of Eligible Startups only after obtaining prior approval of his / her supervisory officer.

Vide clarification issued on 9th August, 2019 it was provided that the provisions of section 56(2)(viib) of the Act would also not be applicable in respect of assessment made before 19th February, 2019 if a recognised Start-up had filed declaration in Form No. 2. The timelines for disposal of appeals before CIT(Appeals) was also specified. Further, the addition made under section 56(2)(viib) would also not be pressed in further appeal.

It has been reiterated time and again by CBDT that outstanding income-tax demand relating to additions made under section 56(2)(viib) would not be pursued and no communication in respect of outstanding demand would be made with the Start-up entity.

2. Income Tax Deduction [Section 80-IAC]

Eligible Startups can claim deduction of 100% of the profits and gains derived by it from a business involving innovation development, deployment or commercialization of new products, processes or services driven by technology or intellectual property and with a high potential of employment generation or wealth creation.

To avail exemption under this Section the Eligible Startup should be **incorporated on or after 01.04.2016 but before 01.04.2022**

The above deduction can be claimed for any three consecutive years out of a period of ten years (ten years beginning from the

3. As defined in Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 2011

4. Circular No 16 dated 7th August 2019 year in which the Eligible Start-up is incorporated) at the option of the start-up.

Process for availing "80-IAC Deduction"

To avail the benefit under the aforesaid section of Income Tax Act,1961, a separate application in *Form 1* in-addition to the DPIIT Recognition application is to be made which is then forwarded to Inter Ministerial Board ["**IMB**"] [5] for further deliberation.

The following documents are to be provided with the application :

1. MOA
2. Previous 3 years financials and income tax returns
3. Pitch Deck explaining the business activities undertaken by the business
4. Video Link explaining the product/service the startup is engaged into and
5. Any other additional documents required by IMB.

Startups that obtain this recognition can be referred to as **"80-IAC Eligible Startups"**

As on 15th December 2022, 990 startups have been given "80-IAC Recognition / Inter-Ministerial Board Recognition"

3. Set-Off and Carry Forward of Losses by Eligible Startups [Section 79]

"Eligible Startups can claim deduction of 100% of the profits and gains derived by it from a business involving innovation development, deployment or commercialization of new products, processes or services driven by technology or intellectual property and with a high potential of employment generation or wealth creation."

[Only for startups that have received Section 80-IAC Recognition]

In case of an Eligible Startup as defined under Sec 80 IAC, the unabsorbed loss incurred in any year prior to the previous year shall be carried forward and set off against the income of the previous year, if all shareholders of such Company who held shares carrying voting power on the last day of the year or years in which the loss was incurred

(i) Continue to hold those shares on the last day of the previous year; and

(ii) Such loss has been incurred during the period of seven years beginning from the year in which such Company is incorporated.

4. Capital Gain Exemption on Transfer of Residential Property

[Section 54GB]

[Only for startups that have received Section 80-IAC Recognition]

(i) Exemption from tax on long term capital gains in respect of Long Term Capital Gains arising to an Individual or HUF on account of transfer of a residential property, if such capital gains are invested in subscription of shares of an Eligible Start-up as defined under Section 80 IAC of Income Tax Act.

(ii) However, such exemption will be available if Eligible Startup utilises the said amount for purchase of Asset specified under the Section 54GB of the Income Tax Act within period of one year.

(iii) If the equity shares of the 80-IAC Eligible Startup are sold or otherwise transferred within a period of five years then the benefit of such exemption would be withdrawn. Therefore there exists a Lock-In of five years on such investments.

5. Deferment of tax liability on ESOPs

[Sections 156, 191 and 192]

5. "Board" means the Inter-Ministerial Board of Certification comprising of the following members:
(i) Joint Secretary, Department of Promotion of Industry and Internal Trade, Convener
(ii) Representative of Department of Biotechnology, Member
(iii) Representative of Department of Science & Technology, Member

[Only for startups that have received Section 80-IAC Recognition]

When an employee exercised their ESOPs, difference between Fair Value as on the date of exercise and Exercise Price will be taxable as perquisites.

Budget 2020 changes this for Employees of Eligible Start up recognised under Section 80IAC of the Income Tax Act by providing benefits by deferring Tax liability. The tax liability in such cases arises within 14 days from any of the following events, whichever is the earliest:

- after the expiry of 48 months from the end of the relevant assessment year; or
- from the date of the sale of such ESOP shares by the assessee; or
- from the date of the taxpayer ceasing to be an employee of the ESOP allotting employee

Liability for deducting tax at source (TDS) on the startup also stands deferred in line with above sections.

6. Capital Gains Exemption for Investing in Units of Funds

[Section 54EE]

Provides for exemption of capital gain arising out of transfer of long-term capital asset (not exceeding INR 50 lakh in a financial year) invested in a fund notified by Central Government. Notification of such funds is awaited from the Central Government.

7. Additional Tax Deduction for "Eligible Employees"

[Section 80JJAA]

This is an important section and tax benefit usually overlooked by Startups. The benefit of this section is available to all companies, including startups and hence included here from a human capital cost incentive benefit, a cost usually associated with Startups.

As per Section 80 JJAA, Where the gross total income of an any assessee exceeds turnover as prescribed u/s 44AB and includes any profits and gains derived from business, there shall be allowed, a deduction of an amount equal to thirty per cent of additional employee cost incurred in the course of such business for three years including the year relevant to the previous year in which such employment is provided.

While this section has further nuances which can be separately analysed, the important points to ensure would be :

(i) *Profitable startups can take advantage of this benefit*

(ii) *Benefit available only for employees with monthly cost less than INR 25,000*

(iii) *Startup to ensure compliance of Provident Fund Regulations*

8. Constitution of Start-up Cell:

Vide order dated 30.08.2019, CBDT has constituted a Start-up Cell under the aegis of Member (IT&C), CBDT to redress grievances and to address various tax related issues in the cases of Start-ups. Grievances can also be filed online at **startupcell.cbdt@gov.in.**

II. Regulatory Benefits

(A) Companies Act, 2013

1. Exemption from preparation of Cash Flow Statement[6]

Eligible Startup is exempted from preparation of Cash Flow Statement and hence they will no longer be required to include cash flow statements as part of their financial statements.

2. Board Meetings per year[7]

Eligible Startup is exempted from holding quarterly board Meetings every year. They are deemed to have complied with the provisions of this section if at least one meeting of the board of directors has been conducted in each half of a calendar year , provided the gap between two board meetings is not less than 90 days.

3. Acceptance of Deposits[8]

"Eligible Startups" can accept deposits from its members without having to comply with certain stringent conditionalities, thereby permitting such companies to raise funds more easily.

6. *G.S.R. 583(E) dated June 13, 2017*
7. *G.S.R. 583(E) dated June 13, 2017*
8. *G.S.R. 639(E) dated June 29, 2016*

> **Eligible Startup is exempted from preparation of Cash Flow Statement and hence they will no longer be required to include cash flow statements as part of their financial statements.**

As per Section 2 (c)(xvii) of Companies (Acceptance of Deposit Rules) 2014, any Convertible Note issued by Eligible Startup will not be considered as Deposit provided, a minimum of INR 25,00,000 is received from a Single Person in Single Tranche and it is either converted or repaid within the period of 10 years.

4. **Sweat Equity Shares** [9]

As per Rule 8(4) of the Companies (Share Capital and Debenture) Rules 2014, Eligible Startups can issue sweat equity shares not exceeding 50% of its paid up capital up to 10 years from the date of its incorporation or registration while the other companies are allowed to issue Sweat Equity upto 25% of paid up equity capital.

5. **Employee Stock Option Plan (ESOP)** [10]

Startups can issue equity under ESOP to their promoters/Promoter group and to directors who hold more than 10% of the existing paid up capital of the Company either directly or indirectly during the first 10 years from the date of their incorporation, while the other Companies are not allowed to issue ESOP to above mentioned categories.

6. **Issuing optionally Convertible Note**[11]

"Convertible note" means an instrument evidencing receipt of money initially as a debt, which is repayable at the option of the holder, or which is convertible into such number of equity shares of the start-up company upon occurrence of specified events and as per the other terms and conditions agreed to and indicated in the instrument

As per amendment to the Companies (Acceptance of Deposits) Rules 2014, a start-up can raise funds by issuing unsecured optionally convertible note without it being amounted to 'acceptance of deposits' subject to the condition that a minimum of INR 25,00,000/- should be received in a single tranche from a single person.

This shall enable startups to raise funds by issuing a debt note convertible into equity shares at the option of the holder and without following tedious compliances. Investors will also be benefited with an exit option available to them in case they choose not to get their debt note converted into equity shares.

7. **Certification of MGT 7 (Annual Return) by Practicing Company Secretary**[12]

Eligible Startup need not get their Annual Return (MGT -7) certified by Practicing Company Secretary. Signature by Directors will be enough for compliance under section 92 of Companies Act 2013.

(B) Foreign Exchange Management Act, 2013

1. **Issuing Optionally Convertible Note** [13]

As per Foreign Exchange Management (Non-debt Instruments) Rules, 2019, an Eligible Startup can raise funds by issuing Optionally Convertible Notes for an amount of Twenty-Five Lakhs or more in Single Tranche, which will be repayable/converted within period of 10 years.

> **"Eligible Startups" can accept deposits from its members without having to comply with certain stringent conditionalities, thereby permitting such companies to raise funds more easily.**

9. *G.S.R. 704(E) dated July 19, 2016*
10. *G.S.R. 704(E) dated July 19, 2016 to be read with G.S.R_ (E) dated 16th August 2019*
11. *G.S.R. 639(E) dated June 29, 2016*
12. *G.S.R. 583(E) dated June 13, 2017*
13. *G.S.R. 3732(E) dated October 17, 2019; Earlier FEMA 20(R) dated November 7, 2017*

One of the primary advantage of issuing Convertible Note, it does not require valuation of the company for issuance of Convertible Note and thus allows more flexibility in issue price.

While there are no pricing guidelines applicable at the time of issuance of a convertible note, the conversion of a note into equity must be in accordance with the pricing guidelines applicable to capital instruments.

Another advantage of issuing Convertible Note is to avoid giving Investors any Control. It also gives investor the flexibility to exit any time by redemption or transfer.

The convertible note may be transferred by way of sale to a person resident in or outside India, provided the transfer takes place in accordance with the entry routes and pricing guidelines as prescribed for capital instruments

2. **Relaxed External Commercial Borrowing Guidelines (ECB's)[14]**

Eligible Startups have been given multiple relaxations with respect to External Commercial Borrowings.

Unlike other Companies, Eligible Startups have no restriction on all in cost ceiling. It has to be mutually agreed between parties. This allows startup to raise funds easily.

Eligible Startups are allowed to raise funds through External Commercial Borrowing without any restrictions on the end-use of such funds raise.

Minimum Average Maturity period for Loan has to be 3 years irrespective of the purpose for which ECB is raised.

Also, Eligible Startup is allowed to borrow from anyone, provided the lender is FATF Compliant Country.

Restrictions with respect to availing ECB only from Foreign Equity Holder for specific usage and maintaining Debt - Equity Ratio have also been removed for Startups.

3. **Relaxation on opening of foreign Bank Account[15]**

Eligible Startup, having an overseas subsidiary, may open a foreign currency account with a bank outside India for the purpose of crediting to the account the foreign exchange earnings out of exports/sales made by the startup or its overseas subsidiary.

The balances held in such accounts, to the extent they represent exports from India, shall be repatriated to India.

In addition, payments received in foreign exchange by an Eligible startup arising out of sales/ export made by the startup or its overseas subsidiaries will be a permissible credit to the Exchange Earners Foreign Currency (EEFC) account maintained in India by the Eligible startup.

> **One of the primary advantage of issuing Convertible Note, it does not require valuation of the company for issuance of Convertible Note and thus allows more flexibility in issue price.**

4. **Investment by a Foreign Venture Capital Investor (FVCI) registered under SEBI (FVCI) Regulations, 2000[16]**

Eligible Startups are allowed to receive funding from Foreign Venture Capital Investors (FVCI) regardless of the sector that the startup would fall under.

(C) Labour Laws

Eligible Startups are allowed to self-certify compliance for 9 Labour Laws and follow a simple procedure for self-certification[17].

Eligible Startups will be allowed to self-certify for a period of five years under various labour laws such as:

(i) The Industrial Disputes Act, 1947

(ii) The Trade Unions Act, 1926

[14] *RBI/2016-17/103 A.P. (DIR Series) Circular No. 13 dated October 27, 2016*

[15] *RBI/2015-16/430 : A.P. (DIR Series) Circular No. 77 [(2)/10(R)] dated June 23, 2016*

[16] *RBI/2016-17/89 A.P. (DIR Series) Circular No. 7 dated October 20, 2016*

[17] *D.O. No Z-13025/39/2015-LR Cell dated April 6, 2017*

(iii) The Building and Other Constructions Workers' (Regulation of Employment and Conditions of Service) Act, 1996

(iv) The Industrial Employment (Standing Orders) Act, 1946

(v) The Inter-State Migrant Workmen (Regulation of Employment and Conditions of Service) Act, 1979

(vi) The Payment of Gratuity Act, 1972

(vii) The Contract Labour (Regulation and Abolition) Act, 1970

(viii) The Employees' Provident Funds and Miscellaneous Provisions Act, 1952

(ix) The Employees' State Insurance Act, 1948

(x) The Apprentices Act 1961[18]

In the case of Eligible Startups who have provided the self-certification, no inspections will be conducted for a period of 5 years. Startups may be inspected only on receipt of credible and verifiable complaint of violation, filed in writing and approved by at least one level senior to the inspecting officer.

28 states in India offer Self-Certification to startups under 6 Labour laws

Process for providing self-declaration online for Labour Compliance

Startups are allowed to submit self-certified returns from second year onwards upto five years from setting up the entity on the *Shram Suvidha Portal* *https://shramsuvidha.gov.in/startUp.action#*

(D) SEBI

Differential Voting Rights[19]

SEBI has approved a framework of shares with differential voting rights for tech startups which will allow startup founders to have a greater control over their ventures.

An issuer company having superior voting rights shares (SR shares) would be permitted to do an initial public offering (IPO) of only ordinary shares to be listed on the Main Board, subject to fulfilment of eligibility requirements of the SEBI (Issue of Capital and Disclosure Requirements) Regulations and other Specified Conditions. The total voting rights of SR shareholders (including ordinary shares), post listing, shall not exceed 74%.

(E) Environment Law Compliances

In case of environment laws, Eligible Startups which fall under the "White Category" (as defined by the Central Pollution Control Board (CPCB) would be able to self-certify compliance and only random checks would be carried out in such cases. Compliance norms relating to Environmental laws have been eased in order to reduce the regulatory burden on Startups thereby allowing them to focus on their

core business and keep compliance costs low.

Eligible Startups will be allowed to self-certify for environment laws such as:

a. Water (Prevention & Control of Pollution) Act, 1974

b. Water (Prevention & Control of Pollution) Cess (Amendment) Act, 2003

c. Air (Prevention & Control of Pollution) Act, 1981

(F) Insolvency and Bankruptcy Code, 2016

Fast Track Process under IBC Code shall apply to Eligible Startup. For Eligible Startups, Insolvency Resolution process be completed within 90 days as against 180 days for other companies.

(G) Intellectual Property

Scheme for facilitating Startups Intellectual Property Protection[20]

Intellectual Property Rights such as Trademarks, Patents and Copyrights are a way of protecting innovative new ideas. However, filing a patent is an expensive and time consuming process which can be difficult for many startups.

18. *D.O. MSDE-6(1)/2016-AP dated January 15, 2016*
19. *SEBI ICDR Regulations*
20. *No 12(30)/2015-IPR-III (Part file 2) dated April 30, 2017*

Eligible Startups shall have the following benefits:

(i) Fast Tracking of Startup Patent Application

(ii) Government to bear facilitation cost: Central Government shall bear the entire fees of the facilitators for patents, trademarks or designs that a Startup may file and the Startups shall bear the cost of only the statutory fees payable.

(iii) Rebate on filing of application: Startups shall be provided an 80% rebate in filing of patents vis-a-vis other companies bringing down the cost from INR 8,000 to INR 1,600[21].

(iv) 50% rebate is also provided in filing of Trademarks vis-a-vis other companies decreasing the cost from INR 10,000 to INR 5,000[22]

(v) panel of facilitators to help in filing of IP applications

As on 4th February 2021, 5,977 startups have been received fee benefits[23]

III. Financial Benefits

(Startups can visit https://gem.gov.in/ to avail the benefits of the above)

1. **Funds of Funds**

To provide equity funding support for development and growth of innovation driven enterprises, the government has set aside a corpus fund of 10,000 crores managed by SIDBI.

The Fund is in the nature of Fund of Funds, which means that the Government participates in the capital of SEBI registered Venture Funds, who further invest in Startups.

2. **Easier Public Procurement Norms**

"Public procurement" refers to the process by which governments and state-owned enterprises purchase goods and services from the private sector. Helping Eligible Startups to participate in the public procurement process and allow them to access another potential market for their products.

(i) *Opportunity to list product on Government e-Marketplace:*

Government e Marketplace (GeM) is an online procurement platform and the largest marketplace for Government Departments to procure products and services. Eligible Startups can register on GeM as sellers and sell their products and services directly to Government entities.

> **"To provide equity funding support for development and growth of innovation driven enterprises, the government has set aside a corpus fund of 10,000 crores managed by SIDBI."**

(ii) *EMD Exemption* [24]

Eligible Startups have been exempted from submitting Earnest Money Deposit (EMD) or bid security while filling government tenders.

(iii) *Exemption from Prior Experience/Turnover* [25]

In order to promote startups, the Government shall exempt Eligible Startups in the manufacturing sector from the criteria of "prior experience/ turnover" without any compromise on the stated quality standards or technical parameters. The Eligible Startups will also have to demonstrate requisite capability to execute the project as per the requirements and should have their own manufacturing facility in India.

21. *http://www.ipindia.nic.in/writereaddata/Portal/News/323_1_Scheme_for_facilitating_start-ups.pdf*
22. *http://www.ipindia.nic.in/writereaddata/Portal/News/323_1_Scheme_for_facilitating_start-ups.pdf*
23. *https://www.startupindia.gov.in/content/dam/invest-india/Templates/public/Startup%20India%20Kit_2021_V2.pdf*
24. *Office Memorandum, Ministry of Finance, Department of Expenditure Procurement Policy Division, Amendment to Rule 170(i) of General Financial Rules 2017; No.F.20/2/2014-PPD(Pt.) dated July 25, 2017*
25. *Office Memorandum, Ministry of Heavy Industries and Public Enterprises, Department of Public Enterprises; No.DPE/7(4)/2007-Fin dated November 8, 2016*

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Startup

Fundraising is an extreme Sport, Be Cautious!

CA. Tarun Chaurasia

Author is member of the Institute. He may be reached at eboard@icai.in

India is an emerging market for start-ups and entrepreneurs as can be witnessed in its growth over the last six years. From a mere 471 Start-ups in 2016 to now nearly 73000 start-ups in 2022, venture capital has meaningfully altered the start-up ecosystem. In its early years, venture capital (VC) was a very small industry but today, it has grown into one of the industry's most significant and widely recognized asset classes.

Looking back to 2021, Indian venture capital deal flow reached an exceptional high of \$38.5B in capital deployed achieving a 3.8x growth over 2020 and a 2x growth in deal volume of making it to 1500+ deals compared to 809 in 2020. Further India minted 44 new unicorns in 2021 passing China with 42 for the first time in terms of unicorn addition. As the Indian start-up ecosystem continues to grow, we now have more than 100 unicorns. Looking at these numbers, one can draw reference that Indian start-up ecosystem has unquestionably reached a maturity point in 2021, hence a reduced deal flow was well expected in 2022. Despite markets across the globe remaining awfully volatile with worries hanging around rising inflation, fears of recession, rising Interest rates and increasing uncertainty resulting from Russia & Ukraine War, India has performed significantly well so far in 2022 in comparison to many other Countries on several economic parameters including Venture Capital Funding.

We have over 900 Alternate Investment Funds (AIFs) registered with SEBI as of May 2022 and have a record dry powder (deployable capital in hand). As per an estimate, nearly US\$9 billion have been raised by India-focused funds during the 12 months ending August 22. This is the capital waiting to be deployed by VCs though there is a reduction in the deal flow in the current calander year 2022 vs 2021.

Considering that we have unprecedented number of Investors in the market with record amount of dry powder waiting to be deployed, clearly funding doesn't seem to be an issue, yet over 90% of the proposals received by Investors gets rejected at the very first glance on account of various reasons. The harsh reality of fundraising is unknown to many entrepreneurs. The mere fact that you wish to raise venture capital doesn't guarantee you will raise it. It is estimated that over 97% of all companies seeking funding do not receive funding. Therefore, the short answer is "you don't" in most cases. It's important to note that the safest place for any VC to park its money would be on selected mature start-ups or Investible Businesses with a proven scalable business model having achieved a traction, a clear path to profitability, and the potential to reach the public markets within a few years.

In this article, we'll discuss some of the most common challenges and mistakes founders and advisors make when seeking equity funding.

A. "Too Early" At any point in time one can find thousands of Entrepreneurs & Start-up Founders looking to raise Funds for their venture which are either at an idea stage or at a stage where minimal viable product (MVP) is yet to be established and even if MVP has been established, the traction is terribly missing. We see many entrepreneurs dropping cold emails to almost every possible investor they come across in the hope that someone will invest. The big question which we are all missing here to ask is; Is it the "right time & stage" of the Business to raise Funds and Will Investors consider such Ventures at such an early stage.

Traction & Scale in the Business is key in today's market. It is the level of progression a start-up makes during its initial

> **Traction & Scale in the Business is key in today's market. It is the level of progression a start-up makes during its initial stages.**

stages. It indicates that their products and services are viable, that they have found the market fit and the brand is growing which eventually gets reflected in the financial and non-financial numbers including revenue, profitability, active users, Key Agreements etc. Investing in start-ups is a risky business for investors and as per the statistic over 90% of the Start-ups failed. Over 90% of the funding proposals received by the Funds gets rejected right at the very first glance on account of various factors whereas the remaining are read through. Only one or two deals eventually meet the expectations of the Investment Committee (IC) and ultimately being readied for Investment. Please note that Investors don't want to invest based just on the founding team alone as they look out for a business that has the potential to grow fast & exponentially. Due to the inherent high risk, Ventures are rarely funded at the Idea Stage, Pre-Seed Stage, or MVP Stage. Even though there are start-ups that raised money before they built anything, when the founders didn't even have a concept, the important thing to remember is that these founders have either led one or more companies to successful exits or have already established a successful track record. These are exceptions and should not be considered as Industry practice. A Founder of an early-stage start-up should resist the temptation to raise too much capital too soon. "Too early for us" is one of the common rejection reasons and therefore founders should never ask for money "too soon"

B. Investment Thesis:

It's not uncommon for entrepreneurs to be turned down multiple times when they try to raise money for their start-ups and in most cases even not receiving a response at all from investors. One will keep facing rejections if the problem is not fixed. A common reason for getting rejection after rejection from investors from the ones to whom the pitch deck is circulated is that of targeting the wrong audience. You may have possibly circulated the pitch deck to a wrong Investor.

The Investors in the Industry are a diverse set and are actively looking out for Investment opportunities. These diverse set of Investors includes High Net worth Individuals (HNI), Angel Networks, Accelerators, Incubators, Family Offices, Corporate Venture Capital, Institutional Venture Capital Fund, Government Start-up Schemes, Private Equity Funds, Sovereign Wealth Funds, Pension Funds, Strategic Investors, Development Financial Institutions (DFI), Insurance Companies, Funds of Funds and many more. They are all looking for Investment opportunities that fits their "investment thesis" and anything that does not meet their thesis is simply gets ignored. Investment thesis is basically a set of rules & principles written & adopted in their Constitutional Document. Regardless of how compelling the proposal is, a deal that extends beyond their investment thesis will be rejected upfront. It is imperative for every Founder & Investment Advisor to understand & read through the investor profile and their investment thesis before proceeding. Believe me, it's really about finding the right investor and you must know your audience well. At the very least, one must visit their website, LinkedIn profile and browse the news Articles related to the Investor & their investments. By doing so, one shall get plenty of information concerning Investors' profile & their sweet spot for Investment. By reading through their profile one can definitely improve the Fundraising Strategy and get quality leads for their campaign.

In India, for example, a large number of foreign domiciled funds made their first investment in India in 2021/2022 by co-investing along with a local lead investor or fund. These Funds invest primarily outside of India or are global Investors and will not have a presence or team in India but have partnered with a local fund on selected investment opportunities. In case you chase them, chances are you'll never hear back from them (let alone rejection) simply because they are keen to evaluate deals independently instead they have a strategic tie up with a local fund.

Investment thesis of the Investors usually comprise of following elements and the least one can do is to educate themself before proceeding for their Fund-raising journey.

(1) Preference for Sectors: Sector focus Fund or Sector Agnostic.

(2) Deal Size: What is the usual minimum & maximum amount of Investment the Investor is willing to make

(3) Are you a Lead Investor vs. Co-Investor

(4) What stage of the Business Investor would invest in i.e. Early Stage or Growth Stage (Private Equity).

(5) Business Stage Can be further categorised into Idea Stage, Pre-Seed Stage, Seed Stage, Bridge Round, Pre-Series A, Series A, B, C D etc.

(6) Do they also Invest in Secondary Transactions (Buying out the existing Investor in the Cap Table)

(7) Is this a Buyout Fund?

(8) What is the negative list of Sectors where Investors would have strict "NO"; exp Alcohol, Gambling etc

(9) Do they have specific Investment theme like; B2B or Impact Investment etc

C. **Professional Help is Key:** Fundraising is an extreme sport. Don't try it yourself. An average funding campaign lasts anywhere between three to six months and is nearly the equivalent of a full-time job. It is common for entrepreneurs to display confidence & optimism and they are always rolling up their sleeves willing to get their hands dirty with almost everything they come across. However, some areas of their business may be too challenging for founders to close unless they have the requisite experience, time and resources. One such task that requires expertise is raising funds as founders should spend their time running their business rather than raising funds. The process of raising capital can be time-consuming and unhealthy which is why it is best outsourced to professionals. It is unfortunate that most founders do not set aside or budget for the time or professional fees for doing this job. Do remember, if you try to achieve everything at your own, there is a high likelihood that you will not succeed. It's always advisable to leverage the experience of someone who knows the job better than you do. As part of the Fund-raising journey, founders would require expert help at every step of the process and more specifically the following.

- Is it the right time & stage for us to raise Funds
- Should we attempt to raise debt and avoid equity at this stage
- How do we prepare a robust Financial Model with built in scenario analysis
- Preparing the Pitch Deck and a Teaser
- Assessing the realistic Valuation of your Company
- Reading through the profile of the Investors and their Investment thesis
- How do we contact the Investors
- Subsequent Interaction with the Investors till you get funded.

D. **Teaser:** Investors' offices are bustling with activity as all kinds of proposals are received through all communication channels each day from all over. It's common to see Founders and Advisors complaining that they have not heard back from Investors.

> **"It is imperative for every Founder & Investment Advisor to understand & read through the investor profile and their investment thesis before proceeding."**

It therefor becomes important to grab investors' attention in this super busy environment and a "teaser" can work very well in favour of a Start-up. Please keep in mind that over 90% of proposals received by investors are rejected at first glance and not even reviewed. The conversion rate is very low here which highlights the importance of the materials that you prepare for potential investors. An Investment Teaser is a professional document used to introduce an investment opportunity. It's a short (one to two pages) and to the point document that outlines the business opportunity for investors and gives a high-level description of the overall business. In the Teaser, you want to make sure the right audience spots your company, engages, and becomes interested in the details.

To enable an investor to make an informed decision, it is crucial to keep the Teaser simple

> **An Investment Teaser is a professional document used to introduce an investment opportunity. It's a short (one to two pages) and to the point document that outlines the business opportunity for investors and gives a high-level description of the overall business.**

and professional, avoid fancy presentations, don't withhold basic and relevant information, and present hard facts upfront. The Teaser will help you filter out your target Audience and you would be able to engage meaningfully with relevant Investors only however please remember, a Teaser is not a replacement of a full deck which will still be needed once you hear back from the Investors on the basis the Investor Teaser. The readers can drop me an email at tarun@pepartners. in in case they are looking for a Teaser format.

E. **Technology:** If you read through the Investment Thesis of Investors, you would notice that almost everyone is looking up to Invest either in Technology Businesses or Tech-Enabled Ventures while traditional small cap or Mid Cap Businesses have practically been ignored by the Venture Capital Industry which are still dependent on the traditional form of Finances and these businesses do not fit into their definition of "Investible Businesses"

The risks and rewards of technology-based ventures are significantly higher as they focus on unproven products, markets, and technologies. Ventures that do not involve technology generally have proven business models whose success depends purely on execution, scale, and sometimes significant investments. Due to strong competition, the returns are usually predictable. The nature of technology-

> **The nature of technology-based ventures gives VCs an advantage over traditional businesses since they disrupt the market or launch a totally novel product or service.**

based ventures gives VCs an advantage over traditional businesses since they disrupt the market or launch a totally novel product or service. Additionally, IP creation often multiplies the investment in tech start-ups many times over. There is of course a high level of risk involved but VC investors usually bet on high-potential projects with the knowledge that they may win a few and fail in a few and those few 10X to 50X value multipliers will make up for the loss. The message is loud & clear if your start-up does not fall into either being a technology Company or Tech Enabled/ Tech oriented Businesses, you will be ignored by a large category of Investors upfront except in a few cases.

Among the most glamorous and exciting facets of finance, venture capital has evolved into a global phenomenon. With unprecedented number of Investors & a record dry powder (deployable capital) available for Investment, Investors are looking up to Investment opportunities and but there is dire need to educate the Founders & Entrepreneurs in their Fund-raising journey.

Working Capital Management for Startups

CA. Deepak Gupta

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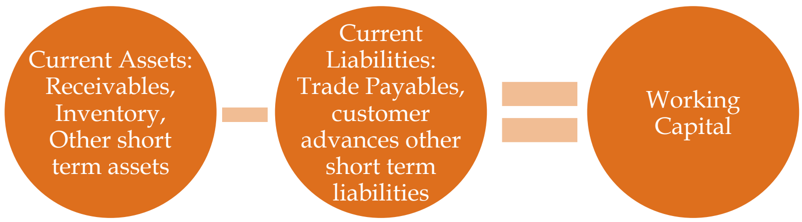
It was 6:30am on Friday, I called my friend, Ravi – founder of a fintech company. I was apprehensive, he would be occupied with his daily chores and might not be available. Fortunately, Ravi picked up the call. Among zillion things hounding attention, he was logging into his company's bank account portal. He informed me that he has an investor's call lined up, an upcoming board meeting needs to be managed for essential matters, and a couple of investors are seeking his time for some critical product updates and need to take certain important calls about insourcing tech and sales functions. I could understand the situation of Ravi, he is stuck in a quandary of balancing between managing tactical problems and working on strategic growth areas. He is a sample of a larger cohort of founders.

Two plights shared by almost all the founders of startup enterprises: First, start the day checking the bank balance and priorities the urgent payouts from the never-ending list of vendor bills that always pile up like mountain. Second, end the day with a sinking feeling of not recovering the total amount against the invoices. Most companies face the double whammy of the cash crunch cycle. On one side, creditors don't give leeway in payment; on the other side, debtors take their own sweet time to pay, disregarding the payment terms. The plight becomes unbearable, with unsold inventories further skewing the liquidity position. The problem statement is significant, but the solutions are simple and require continuous rigour.

Working capital - Ingredients



Before diving deep into the subject, let's understand what working capital comprises.

Working capital management requires hawkish eyes on each element. Various strategic and tactical decisions must be taken to optimize the working capital and ensure it works for the company's benefit.

The working capital may be positive or negative depending on the company's nature. Nevertheless, each element requires careful consideration.

Receivables Management

Trade receivables are the outstanding amount against the goods/ services supplied in the normal course of business. Most startups struggle to get money on time from customers. There can be myriad reasons, but the most common are:

- Not raising an invoice on time
- Incorrect invoice in terms of quantity or price
- Not including adequate details / supporting
- Invoice not submitted to the correct person/function
- Above are some hygiene issues that can be addressed through basic checks and controls.

Receivable management starts when startups enter a contract with

> Trade receivables are the outstanding amount against the goods/ services supplied in the normal course of business.

the customers. In many cases, the payment terms capture the credit period. But it does not specify other terms, such as the pattern in which the invoice needs to be submitted, pricing calculations, and escalation matrix. Micro, Small and Medium Enterprises Act enables Startups and MSMEs to charge interest @ 2% per month on payment delays beyond 45 days. This is missing in the agreed payment terms.

Even if the above is captured, the receivables management of the company does not incorporate the innovative factoring and bill discounting facilities offered by Banks and NBFCs. Many facilities are like non-fund-based limits and can be utilized against a fraction of cash collateral. Effectively utilizing bill discounting will ensure the long waiting period of cash gets curtailed, and companies can lubricate the growing needs of operations.

Some startups also bring out-of-the-box thinking in receivable management through discounts, rewards, and differential customer experience. SaaS Startups are known for collecting the monthly fee in advance, providing decent discounts on quarterly/annual payments in advance.

Whatever approach is taken needs to be evaluated for customer psychology, stickiness to the product and market practice.

With the spurt of various finance solutions, such as Buy Now Pay Later (BNPL), zero-cost EMI solutions to the customers, financing sales upfront against monthly sales and deferred payment and related solutions, it becomes easier to manage receivables. However, it comes with a certain cost and operational complexity. In the above financing mechanisms, if the controls about reconciliations processes are weak and invoice-to-collection steps are not thought through, it will lead to leakage and further aggravate the receivables issues.

Supply chain finance is another avenue for Startups to manage receivables better. In this case, buyers with better credit ratings extend their credit lines to the suppliers (startups) for any credit limit for bill discounting.

Inventory Management

Startups requiring an inventory-based model always face the risk of illiquid/unsold stocks and sales returns. This is especially true for large e-com and direct-to-customer (D2C) brands. Demand forecasting and optimizing the back-end supply chain comes with its own cost regarding resource deployment and management bandwidth. To the great solace, off-the-shelf software is available that integrates orders from various sources and assists in the demand forecast process.

> Receivable management starts when startups enter a contract with the customers. In many cases, the payment terms capture the credit period.

With the regulatory structures placed by e-com market players, D2C brands stock the products on Sales on Return (SOR) basis to e-Com players. The uncontrolled SOR transactions may lead to high inventory and gauge a large chunk of the most important fuel of the company – liquidity. Founders can avoid this situation with a robust plan and strong rigour in the monitoring and review process.

Trade Payables

Managing trade payables requires planning at a granular level and monitoring the business activities in line with the plan. The deviations must be kept at minimal or calculated risk that may lead to known downside risk. Startups struggle to implement the basic controls on budgeting and the PO process. With the lack of controls and absence of a key matrix, the orders are placed without precise planning. The unwarranted trade creditors create a more significant issue in skewed working capital.

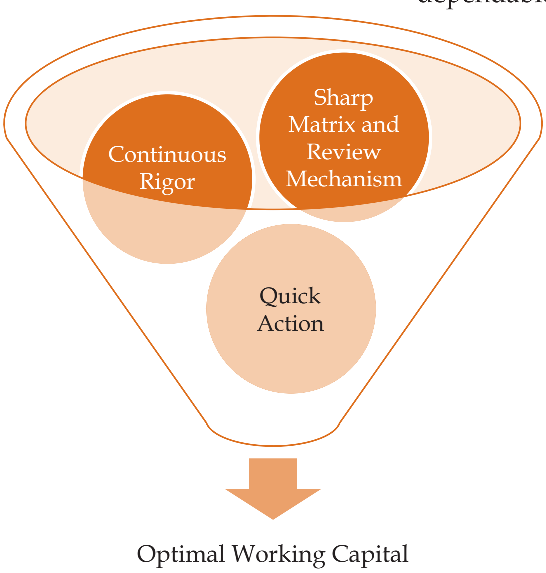
The delay in paying the creditors also leads to dilution in bargaining power to the vendors and sacrificing on the margin due to higher costs.

One issue faced by startups

> Startups requiring an inventory-based model always face the risk of illiquid/unsold stocks and sales returns. This is especially true for large e-com and direct-to-customer (D2C) brands.

with an inventory-based model is identifying the optimal order for Raw Materials in frequency and quantity. Enormous quantities will block the capital, and small amounts will increase inward logistics costs. To overcome this, Companies entered an arrangement with vendors to supply material over a more extended period. Large companies provide support through vendor credit mechanisms. In this, the sellers to start ups provide financing support through their credit line. Startups pay the amount after the agreed period per the arrangement's terms.

Three steps Mantra



Continuous Rigor: Startups suffer from the steroid shot effect. There are knee-jerk reactions when a setback has seen by the companies. Once the situation improves, the business returns to the old operation style. Receivable management, Inventory optimization, payable management and other current assets and liabilities management require continuous rigour from the finance team. Any advances need to be checked with the reason for such payment. Robust control of the receivables with a specific focus on aged debtors ensures improving DSO. Adequate inventory control reduces slow-moving/non-moving inventories, shortening the inventory life cycle.

Sharp Matrix and Review Mechanism: "What is not measured, not improve"
It is quint essential for the companies to create a sharp matrix and have a periodic review with the business team to ensure the key results are achieved as the way envisaged. The input data needs to be dependable to rely on the given matrix. Startups suffer from information silos and sub-optimal ways of capturing adequate data. Once the data is captured correctly, the appropriate matrix can be created to track the progress and monitor the performance.

Quick Action: Review without actions does not make sense. With the dynamic environment, founders need to immediately arrest the depletion of optimal cash flow and the company's working capital. In the case of bill discounting features, the amount must be funded by the company if discounted invoices are not processed on the agreed time. The non-compliance leads to penalties and may jeopardize the credit limit offered by the bank. Similarly, delay in follow-up and taking quick strategic and tactical level intervention may lead to more significant issues.

Fund Utilization Conundrum: There are situations where startups find it difficult to manage their current needs and end up deploying the growth capital in their operation working capital needs. Once done, it enters a conundrum wherein growth gets tapered, and the money blocked in working capital is not released. The situation can be on the reverse side as well. In such cases, illiquid and not profit-making assets are created in the company and lead to a skewed cash position. So, startups need to clearly plan short-term and long-term needs and distinctly approach the problem.

To sum up, Startups are always sandwiched between suppliers who follow up continuously for payment on one side and customers who postpone the payment for multiple reasons on the other side. The negative gap creates fund crunch situations and leads to numerous suboptimal calls the founders take. The founders must evaluate business activities and critical drivers and link them to the company's working capital. Each activity directly or indirectly impacts the company's short- and long-term fund needs.

Startup

The ABC of valuing startups

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The traditional approaches to valuation are inadequate for the valuation of new-age startups. The business model has undergone a fundamental change, especially in the 21st century. Profitability is no longer a key value driver for new age startups. Listed startups like Paytm (which is not even a startup anymore) openly submit that profitability is not their goal in the foreseeable future. In such a day and age, it is imperative that the parameters for valuing such startups be attuned to their business model. In this article, the author attempts to shed light on finding a startup's true value.

Background

- By its very nature, valuation is highly subjective. For instance, let us consider the world-famous painting of the Mona Lisa. The painting is worth billions for some, whereas others may consider it an average work. Therein lies the beauty of valuation; in the eyes of the beholder.
- The three most common globally accepted methods of valuing a business are tabulated below for ease of understanding:

Method	Description
Income approach	Popularly known as the Discounted Cash Flow (DCF) method. In this approach, estimated cash flows for the foreseeable future are discounted to present value and business is valued accordingly.
Asset approach	This approach is generally used when the business is not a going concern viz. during liquidation, untimely losses etc. The assets and liabilities are valued based on their current realisable value and that is considered as value of the business
Market approach	This approach assigns the value of a business based on the value of comparable companies in same/ similar industries, adjusted for their specific parameters.

- These methods have been used in the valuation of businesses for decades and have been accepted by businessmen, lawmakers, Courts and investors alike.
- However, one common feature in the above approaches is that it pre-supposes a business that is established and generates cash flows using its assets.
- Startups, by their very definition, are disruptors. They disrupt industries, products and processes using innovative means. It is difficult to call them "established" in any sense or assume that their cash flows (if not already spent on marketing) will remain constant. Profitability seems to be a cursed word in the startup investor circles.
- As we will explore later in this article, the traditional methods find themselves inadequate to arrive at the value of a new age startup.
- With the dawn of the 21st century, new methods have emerged that attempt to find the startup's true value. But a good valuer understands that the actual value lies less in the numbers and more in the story of the startup.
- In this article, we look at the basics of valuing any business and how to go about valuing a new age startup.

Valuation of startups

- The valuation of startups is often required for bringing in investments either by equity or debt. The most significant differentiating factor in the valuation of a startup is that there is no historical data available based on which future projections can be drawn.
- The value rests entirely on its future growth potential, which, in many cases, is based on an untested idea and may not have been based on an adequate sampling of consumer behaviour or anticipated consumer behaviour. The estimates of future

growth are also often based upon assessments of the competence, drive, and self-belief of, at times, very highly qualified and intelligent managers and their capacity to convert a promising idea into commercial success.

> The valuation of startups is often required for bringing in investments either by equity or debt.

- The major roadblock with startup valuation is the absence of past performance indicators. There is no 'past' track record, only a future whose narrative is controlled based on the founders' skill. It can be equated as founders walking in the dark and making the investors believe that they are wearing night vision goggles. While this is exciting and fun for the founders, this is risky for the investors.
- This is why valuation of startups becomes critical and the role of a professional comes in – it is a way of definitively helping investors navigates the dark using facts, rather than fairy tales.

Why traditional methods cannot be applied?

- Each of the commonly used methods discussed above pre-suppose an established business – which is profitable, has established competitors and generates cash using its assets.
- However, this is missing in new age startups whose value can lie majorly in the concept and potential rather than numbers with a track record.

> The major roadblock with startup valuation is the absence of past performance indicators.

- The failure of each of the traditional methods in case of new age startups is tabulated below:

Method	Why does it fail in case of new age startups
Income approach	A vast majority of startups operate under the assumption of not generating positive cash flows in the foreseeable future. Off late, this business model has been accepted and normalised by the investor community as well. Since there are no or minimal positive cash flows, it isn't easy to value the business correctly.
Asset approach	There are two reasons why this approach does not work for new age startups: 1. **Startups have negligible assets** – a large chunk of their assets are in the form of intellectual property and other intangible assets. Valuing them correctly is a challenge and arriving at a consensus with investors is even more difficult. 2. Startups are new, but usually operate under the going concern assumption; hence their value should not be limited to the realisable value of assets today.
Market approach	New-age startups are disruptors. They generally function in a market without established competitors. Their competition is from other startups working in the same genre. The lack of established competitors indicates that their numbers may be skewed and not be comparable enough to form a base. However, out of the three traditional approaches, we have seen a few elements of the market approach being used for valuing new-age startups, especially during advanced funding rounds.

As we have discussed above, the traditional methods fall short of recognising the true value of new-age startups. The inherent question is what methods we should use for valuing new-age startups. To understand that we have to see what factors drive their value (no prizes for guessing – profitability is not one of them).

Value Drivers for startups

While every startup can be vastly different, we now take a look at a few key value drivers and their impact on the valuation of a startup.

Drivers	Impact on valuation
Product	The uniqueness and readiness of the product or service offered by significantly impact the company's valuation. A company that is ready with a fully functional product (or prototype) or service offering will attract higher value than one whose offering is still an 'idea'. Further, market testing and customer response are key sub-drivers to gauge how good the product is.
Management	More than half of Indian unicorn[1] startups have founders from IIT or IIM. While it may seem unfair prima facie, it is a fact that if the founders are educated from elite schools and colleges, the startup is looked upon more favourably by the investors and stakeholders alike. Accordingly, it is imperative to consider the credentials and balance of the management. For instance, a team with engineers is not as well balanced as a team comprising engineers, finance professionals and MBA graduates. Keeping aside the apparent subjectivity in evaluating the management, the profile of the owners plays a crucial role in valuing the startup.
Traction	Traction is quantifiable evidence that the product or service works and there is a demand for it. The better the traction, the more valuable the startup will be.
Revenue	The more revenue streams, the more valuable the company. While revenues are not mandatory, their existence is a better indicator than merely demonstrating traction and makes the startup more valuable.
Industry attractiveness	The industry's attractiveness plays a vital role in the value of a company. As good as the idea may be, to sustainably scale, various factors like logistics, distribution channels and customer base significantly impacts the startup value. For example, a new-age startup in the tourism industry will be less valuable, as innovative or unique as their offering is if significant lockdowns are expected in the future.
Demand - supply	If the industry is attractive, there will be more demand from investors, making the industry's individual company more valuable.
Competitiveness	The lesser the competitors, the more valuable the startup will be. There is no escaping the first-mover advantage in any industry. While it is easier to convince investors about a business that already exists (for example, it must have been easier for Ola to convince investors when Uber was already running successfully), it also casts an additional burden on the startup to differentiate itself from the competition.

Methods for valuing startups

One key observation would be that most value drivers described above are highly subjective. Hence, there is a need to provide standard methods using value drivers above in order to value the startup in a manner comparable to others.

There are many innovative methods for valuing startups that try to reduce the subjectivity in the valuation of startups that have come in recent times.

Let us take a look at the most common methods of valuing startups:

[1] "Unicorn" is a term used in the venture capital industry to describe a privately held startup company with a value of over $1 billion. The term was first popularized by venture capitalist Aileen Lee, founder of Cowboy Ventures, a seed-stage venture capital fund based in Palo Alto, California.

Method	Particulars
Berkus Approach	The Berkus Approach, created by American venture capitalist and angel investor Dave Berkus, looks at valuing a startup enterprise based on a detailed assessment of five key success factors: (1) Basic value, (2) Technology, (3) Execution, (4) Strategic relationships in its core market, and (5) Production and consequent sales. A detailed assessment is carried out evaluating how much value the five critical success factors in quantitative measure add up to the total value of the enterprise. Based on these numbers, the startup is valued. This method caps pre-revenue valuations at $2 million and post-revenue valuations at $2.5 million. Although it doesn't consider other market factor, the limited scope is useful for businesses looking for an uncomplicated tool.
Cost-to-Duplicate Approach	The Cost-to-Duplicate Approach involves taking into account all costs and expenses associated with the startup and its product development, including the purchase of its physical assets. All such expenses are considered determine the startup's fair market value based on all the expenses. This approach is often criticised for not focusing on the future revenue projections or the assets of the startup.
Comparable Transactions Method	With the traditional market approach, this approach is lucrative for investors because it is built on precedent. The question being answered is, "How much were similar startups valued at?" For instance, imagine XYZ Ltd., a logistics startup, was acquired for Rs 560 crores. It had 24 crore, active users. That's roughly Rs 23 per user. Suppose you are valuing ABC Ltd, another logistics startup with 1.75 crore users. ABC Ltd. has a valuation of about Rs 40 crores under this method. With any comparison model, one needs to factor in ratios or multipliers for anything that is a differentiating factor. Examples would be proprietary technologies, intangibles, industry penetration, locational advantages, etc. Depending on the same, the multiplier may be adjusted.
Scorecard Valuation Method	The Scorecard Method is another option for pre-revenue businesses. It also works by comparing the startup to others already funded but with added criteria. First, we find the average pre-money valuation of comparable companies. Then, we consider how the business stacks up according to the following qualities. • Strength of the team: 0-30% • Size of the opportunity: 0-25% • Product or service: 0-15% • Competitive environment: 0-10%

Method	Particulars
	• Marketing, sales channels, and partnerships: 0-10% • Need for additional investment: 0-5% • Others: 0-5% Then we assign each quality a comparison percentage. Essentially, it can be on par (100%), below average (<100%), or above average (>100%) for each quality compared to competitors/ industry. For example, the marketing team has a 150% score because it is thoroughly trained and has tested a customer base that has positively responded. You'd multiply 10% by 150% to get a factor of .15. This exercise is undertaken for each startup quality and the sum of all factors is computed. Finally, that sum is multiplied by the average valuation in the business sector to get a pre-revenue valuation.
First Chicago Method	This method combines a Discounted Cash Flow approach and a market approach to give a fair estimate of startup value. It works out • Worst-case scenario • Normal case scenario • Best-case scenario Valuation is done for each of these situations and multiplied with a probability factor to arrive at a weighted average value.
Venture Capital Method	As the name suggests, venture capital firms have made this famous. Such investors seek a return equal to some multiple of their initial investment or will strive to achieve a specific internal rate of return based on the level of risk they perceive in the venture. The method incorporates this understanding and uses the relevant time frame in discounting a future value attributable to the firm. The post-money value is calculated by discounting the rate representing an investor's expected or required rate of return. The investor seeks a return based on some multiple of their initial investment. For example, the investor may seek a return of 10x, 20x, 30x, etc., their original investment at the time of exit.

Rising above numbers – The Story

An article about the valuation of startups cannot be complete without understanding the importance of storytelling in the valuation journey.

Professor Aswath Damodaran, expert of valuation, puts forth "If all you have are numbers on a spreadsheet, you don't have valuation You just have a collection of numbers."

Let us attempt to understand the importance of stories in valuation by way of an example of valuing the shares of Rolex. We will try to appreciate company in three scenarios and the reader may assume the role of an investor on the verge of making an investment decision.

Scenario 1 - The earnings of company are slated to grow at 9.5% for the next 8 years before dropping down to the GDP growth rate; the Operating Profit Margin will be 43%, the Net Profit Margin will be 16% and it will be able to generate Rs 2.54 for every rupee invested in the business.

Scenario 2 – Rolex is a manufacturer of luxury watches that can charge astronomically high prices for its watches, earn huge profit margins due to scarcity of luxury watches available to an exclusive club of wealthy individuals.

Scenario 3 – Due to the need to maintain its exclusivity, the revenues of the company will grow at a low rate of 9.5% for the next 5 years. The same need for exclusivity also allows the company to earn an above-average operating margin and maintain stable earnings over time because the client base of the company is relatively unaffected by the highs and lows of the economy.

As the reader would notice, Scenario 1 deals exclusively with the numbers whereas scenario 2 deals with the story. Scenario 1 will not inspire an investor but scenario 2 will not help the investor reach a conclusion either.

It is only in scenario 3 where the value of the business is derived by tying the numbers to the story of the company. Here, the numbers get a backing and are easier to understand for the potential investor. Merging storytelling with the numbers is the real hallmark of a good valuation.

Prof. Aswath Damodaran has laid down a brief five-step process for integrating story into numbers. The same is explained below.

> **"There are many innovative methods for valuing startups that try to reduce the subjectivity in the valuation of startups that have come in recent times."**

Valuation of startups – A cocktail

Nobody knows what the future holds, and valuers are not astrologers, though their success is largely measured by how well they can predict the future.

Step 1: Develop a narrative for the business being valued

- In the narrative, you tell a story about how you see the business evolving over time

Step 2: Test the narrative to see if it is possible, plausible and probable

- There are lots of possible narratives, not all of them are plausible and only a few of them are probable

Step 3: Convert the narrative into drivers of value

- Take the narrative apart and look at how you will translate it into valuation inputs, starting with potential market size, moving onto cash flows, risk. By the time you are done,e ach part of the narrative should be reflected in the numbers and each number should be backed up with a story

Step 4: Connect the drivers of value to a valuation

- Create an intrinsic valuation model that connects the inputs to an end-value in business

Step 5: Keep feedback loop open

- Listen to people who know the business better than you do and use their suggestions to fine tune the narrative/ alter it.

It is said that valuation by itself is a combination of science and art. The author has a unique take – valuation is a scientific art. It is an art constructed by the valuer, yet there is a definite method in the madness. The sanctity of a valuation is preserved by being able to back up the numbers using rational numbers, narratives and assumptions.

New-age startups are disruptors in their own right and a necessary tool for global innovation and progress. By their very nature, startups disrupt set processes and industries to add value. In that process, they transcend traditional indicators of success like revenues, profitability, asset size, etc. Accordingly, it is no mean feat to uncover the actual value of a startup.

While the traditional methods fall short, there is no shortage of new innovative methods used to value startups based on their value drivers. However, the valuation of a startup is much more than the application of ways – it is about understanding the story of the future trajectory and communicating that narrative using substantial numbers.

> **"New-age startups are disruptors in their own right and a necessary tool for global innovation and progress."**

A reasonable valuation of a startup is a cocktail of the story and the numbers which can help the investors make informed decisions to navigate the uncertainty of the future.

Startup

Corporate innovation through Startups

CA. Ninad Karpe

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Isn't corporate innovation essential to keeping up with the competition? But what happens when a company becomes too large to rely on its R&D team? Should the CEO identify another source -- or even several sources -- independent from the corporation itself? According to McKinsey & Company's Global Startup Survey (2108), approximately 40% of large corporations partner with one or more external startups to accelerate their growth. In fact, according to Fortune magazine, more than 83% of Fortune 500 firms have at least one VC-backed startup in its portfolio.

Startups have the potential to become a cost-effective way for large corporations to access new products and services, new technologies, and new talent. Startups iterate their business models faster than big companies and are more open to trying new ideas. And they're usually much more flexible with how they operate compared to big corporations.

If structured meaningfully, the relationship between big corporations and startups could become a win-win. Startups can get access to more resources than ever before -- new markets and new customers that they might not have access to otherwise. Likewise, corporations benefit from working with startups, since they can diversify their portfolios and gain access to new technologies and talent that they may not be able to obtain on their own.

A recent trend shows that corporates are increasingly embracing the concept of "corporate venture capital" (CVC). Broadly, this involves investment by a corporate directly into an external startup. However, before starting the investment, a framework or thesis needs to be developed that can help a company decide whether it should invest in a particular startup. So, what are the points to be considered in building this framework?

1. **Objective:** The corporate needs to define what it wants to get from its investments in startups. Some investments are strategic. They are made primarily to increase the sales and profits of the corporation's business. The other investment objective is financial, wherein a company is mainly looking for attractive returns. Here, a corporation seeks to do as well as or better than private VC investors, due to what it sees as its superior knowledge of markets and technologies, its strong balance sheet, and its ability to be a patient investor. In addition, a company's brand may signal the quality of the startup to other investors and potential customers, ultimately returning rewards to the original investor.

2. **Linkages:** The second defining characteristic of corporate VC investments is the degree to which the startups in the investment portfolio are linked to the investing company's current operational capabilities—that is, its resources and processes. For a company to benefit from a VC investment, it must have some way of developing and exploiting the value created through the venture investment. A startup with strong links to the investing company might make use of that company's manufacturing plants, distribution channels, technology, or brand. It might adopt the investing company's business practices to build, sell, or service its products. Or it might simply serve as a source of innovations that could be applied to the existing product line or processes of the investing company. The degree to which these linkages exist can be measured in terms of the overlap between the company's internal capabilities and those of the investee startup. For example, a pharmaceutical company seeking to develop a new drug for cancer treatment might make a strategic investment in a startup with a new technology that could accelerate the development process and provide new drugs to the market more quickly.

Most investments normally fall somewhere along a spectrum between the two poles. Once the thesis is developed, the company needs to decide on the possible structures for investment. Here are the options:

> Startups can get access to more resources than ever before -- new markets and new customers that they might not have access to otherwise.

1. **Single Direct Investment:** This entails making a direct investment in a new business or in an existing business through the purchase of equity shares or convertible securities in the startup. This is often the first step corporates take into venture capital. It usually involves minority investments in the startup and is decided on in the same way a corporate would decide on an M&A investment.
2. **Multiple Direct Investments:** To support internal R&D efforts, a company could adopt the practice of repeatedly but still opportunistically investing in multiple startups. This approach would not require significant changes to the organization's current structure and processes; it merely involves adopting a disciplined approach to sourcing investment opportunities and tracking their progress until they reach maturity or until the idea becomes obsolete.
3. **Portfolio:** A portfolio of investments takes the multiple direct investments one stage further, combining it with a long term capital commitment to invest in 2-5 deals every year, based on a defined investment strategy.
4. **LP Investment:** Corporates can invest as LPs in independent VC funds. This gives them access to the digital ecosystem and access to startup deals. It also allows them to add considerable value by channeling strategic guidance to the fund managers and managing the exit process of the portfolio companies at a later stage. In addition, it helps them get access to cutting edge technology and the startup talent pool. However, they have limited control over the management and investment decisions of the fund.

To do all this, a corporate has two methods of identifying potential ventures that can be invested.

1. **Internal CVC team:** The CVC team identifies new startup opportunities based on research and analysis of the market opportunities and trends as well as on the company's existing pipeline and products. This team is housed within the company and is responsible for driving the innovation and growth agenda of the business and is therefore closely connected to the company's top management.

> Corporates can invest as LPs in independent VC funds. This gives them access to the digital ecosystem and access to startup deals.

> The CVC team identifies new startup opportunities based on research and analysis of the market opportunities and trends as well as on the company's existing pipeline and products.

2. **External Venture Funds:** Some of the larger organizations prefer to work with external venture capitalists. This method is preferred because it allows them to get first-hand knowledge of the venture capital business while still maintaining control and monitoring the performance of the investments. More importantly, the biggest advantage will be that the external VC firm has the expertise and domain knowledge to evaluate investment opportunities and can secure the best deals for the group. One of the most critical factor in the journey of a CVC model of a corporate is the "deal flow", where an external VC fund can provide a lot of value.

To sum up: It is about time that every corporate should evaluate the option of investing in startups. And till such skill sets are built, a good starting point could be by using an external fund to drive the CVC model. Eventually, only the most innovative companies will survive and the ones which have a good CVC model of investing in startups will probably be ahead of the rest.

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S.No.	Acvtivites	Last Dates
1	Dates of recruiter registration	26rd December, 2022 to 7th January, 2023
2	Dates for Candidate registration	9th to 12th January, 2023
3	Dates of Shortlisting by recruiters	14th to 18th January, 2023
4	Dates of consenting by candidates	20th to 23rd January, 2023
5	Virtual interviews	26th to 28th January, 2023
6	Physical interviews (Abu Dhabi)	31st January & 1st February, 2023
7	Physical interviews (Dubai)	2nd & 3rd February, 2023

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SPECIAL WRITE-UP

India – An Oasis in the desert!

CA. Nilesh Shah

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The Indian economy has grown tremendously over the past few decades, and there is no sign of it slowing down anytime soon. In 1990, the economy was only worth 200 billion dollars. Fast forward to 2021, and it is now worth 3 trillion dollars. If this trend continues, by 2030 the economy is expected to be worth 6 trillion dollars. This presents a huge opportunity for businesses and entrepreneurs alike. We must take advantage of this growth and do in the next 8 years what has taken us 75 years to accomplish.

Many believe that Rahu Kaal is a time when everything goes wrong, but this isn't the case for India. India's Rahu is oil price and Ketu is Covid. From 2014 to 2021, we have seen oil prices cross 100 dollars twice and COVID. In Rahu Kaal, India was the tenth largest economy in 2014 and was the sixth largest in 2021. Today it is the fifth largest, ahead of the United Kingdom. Our market share in terms of GDP has increased from 2.6% to 3.2%. FDI investment share has increased from 2% in 2014 to 7% today. If we have achieved so much even in Rahu Kaal then you can imagine the kind of growth that we can get in the next 25 years when Rahu Kaal is gone.

Over the years, our inflation has decreased from a high inflation rate to a moderate one. If someone says that inflation in India is the highest it's been in 8 years, it's important to note that it's still lower than US inflation rates from the last 14 months. This used to be higher than US inflation in the last 30 years. In the 90s, we had to pledge gold because our forex reserves were so low. Today we are amongst the top 5 forex holders in the world. Infrastructure was very weak earlier. If someone had to go from Mumbai to Pune earlier, it used to be an overnight journey. Today it's only a 4-hour journey. Earlier, if someone had a business idea, funding wasn't available. Today, if you have an idea, you get funding from PE/VC-funded entrepreneurs.

In the last three decades, we have built a strong foundation for India's economy. We were once a small player in the global economy, but now we are a driving force. In 2021, we were the fastest-growing major economy in the world and we are projected to maintain this growth in the next two years. Markets should reflect this long-term growth of the economy. Earnings would improve as the economy grows, and this could cause markets to rise in the long run. There will be ups and downs along the way, but if we look at where the market will be 25 years from now, it is clear that it will be much higher than it is today.

We always wanted to see a day when FIIs are selling while we are buying and markets don't fall. Thanks to retail investors, that day has come. In March 2020, FII sold around 48,000 crs, and Nifty fell from 12,500 to 7,500. From October 21 to June 22, FIIs sold Rs 250,00 crs and markets barely fell 10-12%. This was the

> **In the last three decades, we have built a strong foundation for India's economy. We were once a small player in the global economy, but now we are a driving force.**

power of DIIs who invested in a falling market to help us face FII selling. We are seeing FIIs coming back to India now. People are now not afraid of FII selling. We have a monthly SIP book of 13,000 crs and Rs 45,000 cash ready to be deployed in Equities by Balanced advantage funds.

India's growth story is one that is far more promising and optimistic than many other countries in the world right now. This is because we have relatively low inflation rates, strong growth potential, and better corporate governance standards than many of our peers. Additionally, returns are "green," meaning that we are more environmentally and socially conscious than other countries. This combination of 3G, growth, governance, and green makes India a very appealing investment destination for both local and global investors.

The banking and financial services sector is one that could see a lot of growth in the next 20 to 25 years. This is because banks usually grow 1.5 to 2 times the rate of the economy - since credit is necessary for economic growth. Additionally, there is currently a consolidation trend happening in the banking sector, which means that your deposits or loans are likely to come from only five or six different banks. Non-performing assets are fully provided for and our banking and financial system is overall fairly solid. Plus, margins have increased due to a rise in interest rates lately, and valuations have become reasonable due to a lack of performance in the recent past. Therefore, this sector could drive a lot of growth in the coming years.

The next sector that looks promising for investment is manufacturing. With China +1 policy, many companies around the world are considering investing in India and trying to source products from here. Additionally, the energy crisis in Europe is giving Indian companies more opportunities to shine. We can expect to see similar success stories in other sectors like technical fibres, electronics and auto components, just like we have in IT services, generic pharmaceuticals and two-wheeler automobiles. Manufacturing could see the kind of renaissance that we saw in the IT sector, generic pharma sector, or chemical sector. Good companies which can meet global supply and cover local markets can be beneficial over the long term.

> **This combination of 3G, growth, governance, and green makes India a very appealing investment destination for both local and global investors.**

> **Capital goods could lead the next leg of growth as we begin to see an increase in demand from both the public and private sector.**

Capital goods could lead the next leg of growth as we begin to see an increase in demand from both the public and private sector. Companies in this sector have started to see a surge in orders and capacity utilization has now crossed the pre-COVID level. Additionally, on the export market, some multinational companies are looking to shift their sourcing from China to India. So, overall industrial and capital goods is one sector where there is a great opportunity for growth in the years to come. We are at an advantage as all three customers; the government, the private sector and exports are firing. The government was earlier giving orders and the tax revenues are fairly solid, they are sitting on three to four lakh crore of cash to spend, the private sector capex has been revived in renewable energy in commodities, and the exports market has opened up. Therefore, Capital goods are likely to be firing on all three fronts i.e. government, private sector and exports.

To sum it up, stay invested in India's future. Be a regular investor - even small contributions can add up over time. Be a long-term investor - good things take time. Be a disciplined investor. Follow your asset allocation and don't put all your eggs in one basket.

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The Institute of Chartered Accountants of India

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TAXATION

Overview of Section 194R

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Section 194R: Deduction of Tax on benefit or perquisite in respect of business or profession. Section 194R is introduced by the Finance Act, 2022 and is applicable from 1st July 2022. Before deep diving into Section 194R, we may need to understand a few concepts useful for interpreting Section 194R. For the understanding purpose, we may take the help of dictionary for the words "Benefit" and "Perquisite" used in Section 194R.

*"**Benefit"** is not limited to pecuniary gains, nor any particular kind of advantage; it refers to what is advantageous, whatever promotes prosperity or happiness, and what enhances the value of the property or rights of citizens as contradistinguished from what is injurious.*

From the above, we can understand that the word benefit has a very wide import. The benefit is something that is not only connected with any monetary, financial, or economic gains, however, it also includes advantages or any kind of non-monetary gains.

"Perquisite" *– Emoluments or incidental profits attached to an office or official position, beyond salary or regular fees.*

Perquisite is always connected to an office or official position. It's in addition to salary or regular fees.

Section 17(2) of the Income-tax Act defines "Perquisite" in an inclusive way to include-

(i) Value of any **rent-free accommodation** provided to the employee;

(ii) Value of any **concession** in the matter of rent respecting any accommodation provided to the assessee by his employer.

(ii) Value of any **benefit or amenity** granted or provided free of cost or at a concessional rate to an employee

(iii) Sum paid in respect of **any obligation payable by the** employee;

(iv) Sum payable to a fund, other than a recognised provident fund or an approved superannuation fund, **to effect an assurance on the life of the employee or to effect a contract for the annuity**;

(v) **Value of any specified security or sweat equity shares** allotted or transferred, directly or indirectly, by the employer, or former employer, free of cost or at a concessional rate to the assessee.

(vii) The amount or the aggregate of amounts of any contribution made to the account of the assessee by the employer-

(a) In a recognised provident fund;

(b) In the scheme referred to in sub-section (1) of Section 80CCD; and

(c) In an approved superannuation fund,

To the extent, it exceeds seven lakh and fifty thousand rupees in a previous year;

(vii) The annual **accretion by way of interest, dividend or any other amount** to the balance at the credit of the fund or scheme referred to in sub-clause(vii); and

(viii) Value of any other fringe benefit or amenity as may be prescribed.

Rule 3 of Income tax rules prescribe value for the benefits or amenities-

(i) **Interest-free or concessional loans** to the employee or any member of his household;

(ii) **Value of travelling, touring, accommodation** and any other expenses paid for or borne or reimbursed by the employer for any holiday availed by an employee or any member of his household;

(iii) Value of **free food and non-alcoholic beverages** provided by the employer to an employee;

(iv) Value of any **gift or voucher or token** instead of which such gift may be received by the employee or by a member of his household on ceremonial occasions;

(v) The number of expenses including **membership fees** and **annual fees** incurred by the employee or any member of his household, which is charged to a credit card provided by the employer or paid for or reimbursed by such employer;

(vi) Payment or reimbursement of **expenditure** incurred **in a club** by an employee or any member of his household;

(vii) Value of any benefit to the employee resulting from the **use of a movable asset (*other than assets already specified in this rule and other than laptops and computers*)** by the employee or any member of his household;

(viii) Value of any benefit to the employee arising from the **transfer of any movable asset** belonging to the employer directly or indirectly to the employee or any member of his household;

(ix) Value of **any other benefit or amenity, service, right or privilege** provided by the employer shall be determined based on the cost to the employer.

From above it transpires that any emoluments or benefits included under Section 17(2) of the IncomeTax Act provided by the employer to his employees be considered as Salary.

The rationale behind introducing Section 194R

The tax benefits passed on in the name of business strategy by businesses to their agents, transpires from Finance Minister's Budget Speech 2022-23.

Finance Ministers Speech Budget 2022-23-
"It has been noticed that as a business promotion strategy, there is a tendency on businesses to pass on benefits to their agents. Such benefits are taxable in the hands of the agents. In order to track such transactions, I propose to provide for tax deduction by the person giving benefits, if the aggregate value of such benefits exceeds ₹ 20,000 during the financial year."

Let us now understand whether benefits or perquisites are Income

If we read Section 2(24) of the Income-tax Act, the word benefit or perquisite is used in clauses like (iii), (iiia), (iv) and (iva) of Section 2(24). Each clause is reproduced below for the sake of convenience.

Section 2(24)(iii)- the value of any perquisite or profit in lieu of salary taxable under clauses (2) and (3) of section 17.

Section 2(24)(iiia)- any special allowance or benefit, other than perquisite included under sub-clause (iii), specifically granted to the assessee to meet expenses, necessarily and exclusively for the performance of the duties of an office or employment of profit.

Section 2(24)(iv)- the value of any benefit or perquisite, whether convertible into money or not, obtained from a company either by the director or by a person who has a substantial interest in the company, or by a relative of the director or such person, and any sum paid by any such company in respect of any obligation which, but for such payment, would have been payable by the director or other person aforesaid.

Section 2(24)(iva)- the value of any benefit or perquisite, whether convertible into money or not, obtained by any representative assessee mentioned in clause (iii) or clause (iv) of sub-section (1) of Section 160 or by any person on whose behalf or for whose benefit any income is receivable by the representative assessee (such person being hereafter in this sub-clause referred to as the "beneficiary") and any sum paid by the representative assessee in respect of any obligation which, but for such payment, would have been payable by the beneficiary.

In addition to the above *Section 2(24)(vd)* says Income includes *"the value of any benefit or perquisite taxable under clause (iv) of Section 28."*

Accordingly, Section 28(iv) of the Income-tax Act, says –

"the value of any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession." as income chargeable to income tax under the head "Profits and gains of business or profession"

> **Section 194R talks about any benefit or perquisite provided to a resident by any person, arising from business or the exercise of a profession, by a such resident.**

From the above, it can be concluded that benefit or perquisite is Income under Section 2 (24) of the Income-tax Act. Accordingly, chargeable to tax.

Let us now decode Section 194R clause by clause-

Section 194R(1) – *Any person responsible for providing to a resident, any benefit or perquisite, whether convertible into money or not, arising from business or the exercise of a profession, by such resident, shall, before providing such benefit or perquisite, as the case may be, to such resident, ensure that tax has been deducted in respect of such benefit or perquisite at the rate of ten percent of the value or aggregate of the value of such benefit or perquisite.*

Section 194R talks about any **benefit or perquisite** provided to a resident by any person, arising from business or the exercise of a profession, by a such resident.

We have already seen benefits and perquisite both are income and are accordingly subject to tax.

On reading the above sub-clauses, one may conclude that benefits or perquisites are income and accordingly chargeable to tax. Now one may have a question in case of perquisites whether TDS under Section 192 or TDS under Section 194R would be applicable.

The perquisite defined under Section 17(2) is an inclusive definition. Value of emoluments of the nature referred in clauses (i) to (viii) in Section 17(2) to be considered as "Salaries" liable to deduct TDS under Section 192 of the Income-tax Act.

This excludes emoluments that are outside the purview of Section 17(2) such as an employee who is not paid any monetary emoluments but is provided rent-free accommodation, providing as per company policy stay in luxurious hotels in India or abroad and accounting in the books of a company under any nomenclature to show as a business expense or any such other benefits which are provided to certain valuable employees and are the outside purview of monetary consideration or from the purview of Section 17(2) of the Income-tax Act.

Similarly, to retain business many corporates provide benefits to their dealers or channel partners other than monetary payments, all such benefits provided are subject to TDS under Section 194R.

From the reading of clause (1) of Section 194R, it is clear that such perquisites whether convertible into money or not arising from business or exercise of the profession are subject to TDS at 10%.

First Proviso to clause (1) of Section 194R –

"Provided that *in a case where the benefit or perquisite, as the case may be, is wholly in kind or partly in cash and partly in kind but a such part in cash is not sufficient to meet the liability of deduction of tax in respect of the whole of such benefit or perquisite, the person responsible for providing such benefit or perquisite shall, before releasing the benefit or perquisite, ensure that tax required to be deducted has been paid in respect of the benefit or perquisite."*

First Proviso to Section 194R (1) casts responsibility on the person responsible for providing such benefit and not on the person providing such service. We have seen that corporates provide benefits to maintain business, in such a case, corporates need to deduct TDS.

TDS needs to be deducted before releasing the benefit or perquisite. Normally, we have seen TDS provisions where they mention –

"S. 194J-………. Shall at the time of such sum to the account of the payee or at the time of payment thereof in cash or by the issue of a cheque or draft or by any other mode, whichever is earlier…."

Here, there is a slight change where section emphasis of before releasing the benefit or perquisite. This is because there may be instances where two TDS provisions apply together.

Example- Suppose Company 'A' an Automobile manufacturer has achieved desired sales target and wants to pass benefits to its dealers but in a non-monetary manner. Accordingly, they book hotel rooms in their name in September, for Christmas week during that year and give benefits to their dealers for meeting sales targets.

Here, Company 'A' would have deducted TDS under Section 194C/194I, when they would have made payments/ passed credit in their books towards hotel bookings. Finally, when they pass on the benefit to their dealers in November by letting them know that they are selected for the Christmas week holidays they are passing benefits to their dealers in November. So, the TDS under Section 194R needs to be deducted again in November before passing on the benefits.

> **The third proviso makes it clear that provisions of section 194R apply to the Individual or HUF, only when they are in a business having total sales, gross receipts or turnover exceeding Rs. 1 crore and in a profession exceeding Rs. 50 lacs.**

In our example, the benefits are purely non-monetary and hence TDS may have to be borne by Company 'A' itself.

However, it might be different in case Company 'A' was owning that hotel and it was allowing its dealers to enjoy the benefits. In such cases TDS under Section 194R would be only applicable.

> **If any benefit is provided by any resident to a non-resident, then Section 194R would not be applicable, however, the resident needs to deduct TDS under Section 195 on the value of the benefit provided if taxable.**

Second Proviso to clause (1) of Section 194R –

"Provided further that the provisions of this section shall not apply in case of a resident where the aggregate value of the benefit or perquisite provided or likely to be provided to such resident during the financial year does not exceed twenty thousand rupees"

The Second proviso has put a threshold limit of Rs. 20,000 for applicability of Section 194R.

Third Proviso to clause (1) of Section 194R-

"Provided also that the provisions of this section shall not apply to a person being an individual or a Hindu undivided family, whose total sales, gross receipts or turnover does not exceed one crore rupees in case of business or fifty lakh rupees in case of profession, during the financial year immediately preceding the financial year in which such benefit or perquisite, as the case may be, is provided by such person"

The third proviso makes it clear that provisions of section 194R apply to the Individual or HUF, only when they are in a business having total sales, gross receipts or turnover exceeding Rs. 1 crore and in a profession exceeding Rs. 50 lacs. In the case of the Company, there are no such limits, every transaction of such nature is subject to TDS.

Section 194R (2) is giving power to Board to issue guidelines for the purpose to remove the difficulty.

Section 194R (3) states that every guideline issued by the Board under sub-section (2) shall, as soon as may be after it is issued, be laid before each House of Parliament, and shall be binding on the income-tax authorities and the person providing any such benefit or perquisite.

I may also take the opportunity to clarify a few questions that arose in my mind –

(i) The above section applies to any benefit provided by a non-resident to the resident.

(ii) If any benefit is provided by any resident to a non-resident, then Section 194R would not be applicable, however, the resident needs to deduct TDS under Section 195 on the value of the benefit provided if taxable. ■■■

New Era of Taxation – GloBE Rules under Pillar 2

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Digitalisation of world economies has made it imperative for the authorities to introduce some new concepts of taxation, so that taxes are paid where economic activities are carried out and value is created. Current prevailing principles of taxation based on the concept of physical presence (or, permanent establishment (PE)) are no longer appropriate for businesses, which could carry out substantial activities in a country via digital technologies, without any physical presence whatsoever.

OECD[1]/ G20 Inclusive Framework on Base Erosion and Profit Shifting (BEPS) has continuously worked to address the challenges arising from digitalisation of the economies and has come up with the Two Pillars solution to change international tax rules so that businesses can pay their fair share of taxes in the locations of their activities.

Pillar 1 inter-alia provides for giving some taxation rights to market jurisdictions where MNE do not even have PE and allocates some portion[2] of non-routine/ residual profit to the said market jurisdictions using a revenue-based allocation key. Basically, Pillar 1 will rewrite profit allocation and nexus rules so that MNEs pay taxes in jurisdictions in which they have consumers. Whereas Pillar 2 proposes a minimum tax that a MNE group should pay (also known as, top-up tax[i]) with respect to the income of low taxed jurisdictions. After the issuance of Pillar 2 Blueprint in October 2020, OECD/ G20 Inclusive Framework has now come up with draft Global Anti-base Erosion (GloBE) Model Rules[ii] in December 2021, that provides a fine print of how Pillar 2 is intended to work. A detailed commentary[iii] on said Rules is also released in March 2022, which provides explanation to the Rules and various nuances relating to them.

It is imperative to note that GloBE rules do not compel any jurisdiction to adopt some minimum taxes; what it does is that where effective tax rate of the jurisdiction is below the minimum rate, it allows other countries to recover top-up tax on low taxed income. GloBE Rules are applicable on MNE Groups having total consolidated group revenue of €750 million or above, in at least two of the four fiscal years immediately preceding the tested fiscal year.

Overview

- GloBE Rules mainly comprise of following two rules –
  - i) **Income Inclusion Rule (IIR)** – This rule will effectively make the MNE group pay a minimum level of tax in each country in which it operates;
  - ii) **Undertaxed Payment Rule (UTPR)** – This rule acts as a backstop rule to IIR, where IIR is not sufficient to recover the top-up taxes.
- **Income Inclusion Rule (IIR)**

  IIR effectively brings to tax income of low tax constituent entities[iv] (LTCE) to an agreed minimum rate by making the parent entity (in most cases, the Ultimate Parent entity[v] (UPE)) pays taxes on its allocable share of top-up tax of LTCE. Simply, constituent entities (CEs) can be understood to mean the entities which are consolidated with the financial statements of UPE on line-by-line basis.

1. Organisation for Economic Co-operation and Development

2. Between 20% to 30%

Simple diagrammatic representation of the flow of IIR:-

Steps	*Key Consideration Points*
1. **Identification of CEs** of MNE Group's →	- What is meant by **MNE Group**[vi], **Constituent Entities (CE)**[vii], **Ultimate Parent Entity (UPE), Fiscal year**[viii] - Whether entities are **Excluded Entities** *(refer to notes below)*
↓	↓
2. Computation of **GloBE Income or GloBE Loss** of CEs →	- **Adjustments** to be made to determine GloBE Income or GloBE Loss. For example, excluded dividends and asymmetric foreign currency gains. *(refer Article 3.2 of GloBE Rules)* - Deciding election to **Spread Capital Gains** over five years - Adjustment in respect of **Intragroup Financing Arrangement** - **Exclusion** for International Shipping Income. *(refer to Article 3.3 of GloBE Rules)*
↓	↓
3. Computation of **Adjusted Covered Taxes** of CEs →	- What are **Covered Taxes**[ix] - Various **Additions/ Reductions** from Covered Taxes to compute Adjusted Covered Tax
↓	↓
4. Calculate **Effective Tax Rate** (ETR) of the MNE Group for a jurisdiction and **Top-up Tax Percentage** →	- Formula for ETR = Sum of the Adjusted Covered Taxes of each Constituent Entity located in the jurisdiction / Net GloBE Income of the jurisdiction - Investment entities are excluded from the determination of ETR - Formula for Top-up Tax Percentage = Minimum Rate (15%) (–) Effective Tax Rate - Applying Substance-based Income Exclusion to the Net GloBE Income to determine excess profits - Jurisdiction to determine the Excess Profits in that jurisdiction
↓	↓
5. Computation of **Excess Profit** for a jurisdiction →	- **Formula of Excess Profit** = Net GloBE Income (-) Substance Based Income Exclusion - Substance based income exclusion is the sum of the **payroll carve-out** and the **tangible asset carve-out**. This exclusion is basically provided so jurisdictions may still offer tax incentives that help in the reduction of normal routine returns from investment in substantive activities, without any additional GloBE Top-up Tax liability *(refer to Article 5.3 of GloBE Rules)*.
↓	↓
6. Computation of **Jurisdictional Top-up Tax** and Top-up Tax of a CE →	- **Formula for Jurisdictional Top-up Tax =** (Top-up Tax Percentage X Excess Profit) + Additional Current Top Up Tax– Domestic Top Up Tax - **Formula for Top-up Tax of a CE =** Jurisdictional Top-up Tax X GloBE Income of CE / Aggregate GloBE income of all CEs - A De Minimis exclusion is provided where revenue is less than €10 million and profit is less than €1 million in a jurisdiction (on an average basis for 3 fiscal years). The Top-up tax shall be considered ZERO in such cases.
↓	↓
7. **Allocate the top-up taxes** in Parent Entities' Inclusion Ratios →	- **Allocation** of top-up taxes to Ultimate Parent Entity/ Intermediate Parent Entity/ Partially-Owned Parent Entity - What is Parent Entity's **Inclusion Ratio?** - **IIR Offset mechanism** to avoid double taxation

Note

- IIR follow top-down approach in its implementation. In other words, priority is given to the jurisdiction of the CE that is at or near the top of the ownership chain in the MNE Group (starting with the UPE). In the event the UPE is not located in a jurisdiction that has implemented the IIR, the Top-up Tax is imposed on the next Intermediate Parent Entity in the ownership chain that is subject to the IIR.
- The following entities are inter-alia included in the list of Excluded Entities:-

  (a) a Governmental Entity;

  (b) an International Organisation;

  (c) a Non-profit Organisation;

  (d) a Pension Fund;

  (e) an Investment Fund that is an UPE; or

  (f) a Real Estate Investment Vehicle that is an UPE
- Government entities are covered under the list of Excluded Entities. Definition of Government Entity (Article 10.1) inter-alia other conditions provide that entity should not carry on a trade or business. It will be important to analyse whether Indian PSUs will get covered under the said exclusion or not, especially considering that they may be considered to carry on trade or business.

- **Undertaxed Payment Rule (UTPR)**

  UTPR provides a mechanism for making an adjustment in respect of the Top-up Tax that is not brought within the charge of IIR. Top-up tax calculated under IIR and UTPR follows the same computation mechanism.

  Top-up tax is allocated to countries which have adopted the UTPR using the formula:

  $$\frac{50\% \text{ X No. of employees in the jurisdiction}}{\text{No. of employees in all UTPL jurisdictions}} + \frac{50\% \text{ X Total value of Tangible Assets in the Jurisdiction}}{\text{Total value of Tangible Assets in all UTPL jurisdictions}}$$

  Group companies will be denied a deduction or required to make an equivalent adjustment under domestic law.

Illustration to understand that IIR application

Let us try to understand the above Rules with the help of an example. Suppose, A Co is located in Country A and is the UPE of the ABC Group. A Co directly owns B Co 1 and B Co 2, both located in Country B. B Co 1 hold 100% of the Ownership Interests in C Co 1, C Co 2 and C Co 3, which are Constituent Entities located in Country C. B Co 2 each hold 100% of the Ownership Interests in D Co 1, D Co 2 and D Co 3, which are Constituent Entities located in Country D.

The consolidated group revenue (in Euro million) for the different years for ABC group are as under:

	Year 1	Year 2	Year 3	Year 4	Year 5
Revenue	500	800	400	900	300

Further, details of Covered Taxes and GloBE Income of the various entities are as mentioned below:-

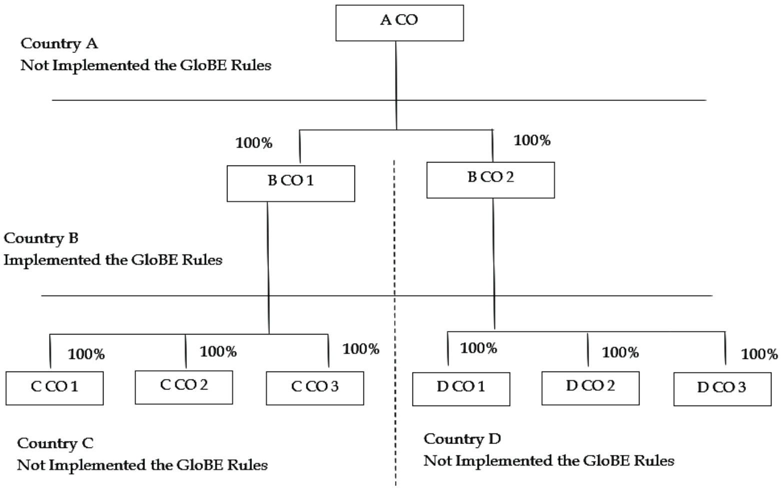
	C Co 1	C Co 2	C Co 3
Covered Taxes	300	400	200
GloBE Income	1500	2000	2400

	D Co 1	D Co 2	D Co 3
Covered Taxes	100	200	130
GloBE Income	1000	1200	1500

ABC Group wants to test the applicability of GloBE Rules, to the group, in Year 5. Of the four jurisdictions, only Country B has implemented a Qualified IIR. It is assumed that none of the entities are Excluded Entities and ABC Group does not have any income from International Shipping Business.

> **“GloBE Rules are applicable on MNE Groups having total consolidated group revenue of €750 million or above, in at least two of the four fiscal years immediately preceding the tested fiscal year.”**

A diagram illustrating the holding structure and location of the members of the ABC Group is set out below.



Discussion

In Year 2 and Year 4,the consolidated group revenue of ABC Group is more than €750 million and hence, it is covered under the GloBE Rules.

Computation of ETR

	C Co 1	C Co 2	C Co 3	Total
Covered Taxes (A)	300	400	200	900
GloBE Income (B)	1500	2000	2400	5,900
ETR % (A/B)	20%	20%	8.33%	15.25%

In this case, jurisdictional ETR is 15.25%,which is more than 15%. Hence, Country C is not a low taxed jurisdiction. Even when C CO 3 has ETR below 15%, for the purpose of GloBE Rules, it is jurisdictional ETR that needs to be taken into consideration. Therefore, there is no top-up tax liability with respect to Country C.

	D Co 1	D Co 2	D Co 3	Total
Covered Taxes (A)	100	200	130	430
GloBE Income (B)	1000	1200	1500	3700
ETR % (A/B)	10%	16.67%	8.67%	11.62%

In this case, jurisdictional ETR is 11.62%,which is less than the minimum agreed rate of 15%. Hence, Country D is a low taxed jurisdiction. Top-up Tax Percentage will be (15%- 11.62%) i.e., 3.38%. Therefore, top-up tax liability will be 3.38% of 3700 i.e., 125.06. It is important to note that top-tax liability will also be payable with respect to D Co 2, though its individual ETR is more than 15%.

A CO i.e., UPE of the ABC Group has not implemented IIR and hence, as per the top-down approach, the next immediate parent entity in the ownership will be required to implement IIR. In this case, it is B CO 2 that will be required to pay the top-up tax liability in respect to Country D as it is holding completed Ownership Interest in D Co 1, D Co 2 and D Co 3.

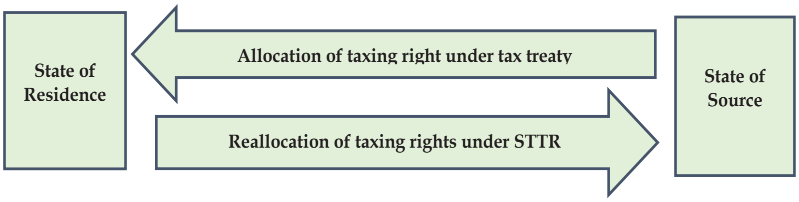
Best of the rest

- **Switch-Over Rule (SOR)** – There are concerns in relation to application of IIR, where a Parent Entity jurisdiction has entered into DTAAs in which it has adopted the exemption method (instead of a credit method) to eliminate double taxation of income arising in the other jurisdiction.

  In this regard, SOR could safeguard the application of IIR with respect to income of the PE; it would, by virtue of its domestic law trigger, allow the residence country to tax the low-tax profits of a PE up to the agreed minimum rate, using the same test as the IIR.

- **Subject to Tax Rule (STTR)** – This will complement the GloBE Rules. It is a treaty-based rule that specifically targets risks to source countries posed by BEPS structures relating to intragroup payments that take advantage of low nominal rates of taxation in the other contracting jurisdiction (that is, the jurisdiction of the payee).

  It allows the source jurisdiction to impose additional taxation on certain covered payments up to the agreed minimum rate. This rule acts as priority rule to GloBE Rules.



- **Some open consideration points**

  Countries that have already implemented Controlled Foreign Corporation (CFC) rules and are considering to implement an underlying minimum tax regime, have to decide whether its qualified domestic minimum top-up tax rules should credit CFC taxes and vice versa.

Commentary to the GloBE rules provides that in order to reduce compliance and administrative cost to MNEs and tax authorities, GloBE Implementation Framework[x] will seek to explore the development of GloBE Safe Harbours, which will allow MNE Group to avoid the ETR and Top-up Tax calculation in respect of its operations that are likely to be taxable at or above the Minimum Rate. They would also provide for improved tax certainty and transparency in the use of risk assessment under the GloBE Rules. However, detailed particulars of said Safe Harbours are still awaited and will be released as part of the GloBE Implementation Framework.

Standard template of the GloBE Information Return[xi] is yet to be developed and requires further work from GloBE Implementation Framework.

> **“UTPR provides a mechanism for making an adjustment in respect of the Top-up Tax that is not brought within the charge of IIR.”**

Concluding Remarks

The OECD/G20 Inclusive Framework on BEPS is in the process of developing an Implementation Framework to support tax authorities in the implementation and administration of the GloBE Rules. It will also be important to watch as to when OECD will introduce model treaty / MLI provisions to facilitate the implementation of STTR. Since, no new provisions are contained in the Finance Act, 2022 regarding the GloBE Rules, it is expected that the Indian government may introduce the domestic legislation in this regard by way of an ordinance, to be implemented from 2023. It would be imperative for businesses to proactively analyse the applicability and implications of rules to their facts so that they can be ready to implement and ensure compliance.

i. **Top-up tax** is computed for the jurisdiction or Constituent Entity pursuant to Article 5.2 of the GloBE Rules

ii. OECD (2021), Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS, OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-the-digitalisation-of-theeconomy-global-anti-base-erosion-model-rules-pillar-two.htm.

iii. OECD (2022), Tax Challenges Arising from the Digitalisation of the Economy – Commentary to the Global Anti-Base Erosion Model Rules (Pillar Two), OECD, Paris, https://www.oecd.org/tax/beps/tax-challenges-arising-from-thedigitalisation-of-the-economy-global-anti-base-erosion-model-rules-pillar-two-commentary.pdf.

iv. **Low-Taxed Constituent Entity** means a Constituent Entity of the MNE Group that is located in a Low-Tax Jurisdiction or a Stateless Constituent Entity that, in respect of a Fiscal Year, has GloBE Income and is subject to an Effective Tax Rate in that Fiscal Year is lower than the Minimum Rate.

v. **UPE** is basically an entity that owns controlling interest in any other entity and is not owned, with a controlling interest by another entity *(for detail, refer Article 1.4. of GloBE Rules)*

vi. An MNE Group means any Group that includes at least one Entity or PE that is not located in the jurisdiction of the UPE.

vii. A Constituent Entity is any Entity that is included in a Group; and any PE of such Main Entity.

viii. Fiscal Year means an accounting period with respect to which the UPE of the MNE Group prepares its Consolidated Financial Statements.

ix. For meaning of Covered Taxes, refer Article 4.2 of GloBE Rules.

x. The **GloBE Implementation Framework** provides for guidance and processes agreed by the Inclusive Framework to facilitate the co-ordinated implementation of the GloBE Rules, including the further development of the common methodology for allocating the Covered Taxes of those specific country tax regimes for which more detailed or distinct allocation rules are needed.

xi. **GloBE Information Return** means that standardised return to be developed in accordance with the GloBE Implementation Framework that contains the information described in Article 8.1.4.

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Apposite of Article 3(2) of OECD model tax convention

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Organisation for Economic Co-operation and Development (OECD) commentary on Article 3(2) provision and its history is very illuminating. Language similar to Article 3(2) first appeared in U.S. Treasury Regulations[1] issued in 1940 and its first use in a treaty occurred in the US - UK treaty 1945[2]. Paragraph 2 of Article 3 of the OECD Model Convention, 2017 (after this referred as "OECD Model Convention" or "OECD MTC") provides that, for the convention, any terms that are not defined in it have the meaning it had at that time under that state's law unless the context requires otherwise. Paragraph 2 of Article 3 of the OECD MTC, therefore, provides leverage to domestic legislation but is concerning the context.

This paper attempts to look at the detailed overview of paragraph 2 of Article 3 of the OECD MTC. The analysis is intended to understand the interpretative issues for vague treaty terms (see section 3). In this regard, the relevance of context has been discussed in detail (see section 4) with the relationship between Article 3(2) of OECD MTC with Articles 31, 32 of the Vienna Convention on the law and treaties (after this referred as "VCLT") (see section 5).After that , the analysis focuses on the interplay of Article 3(2) of the OECD MTC with the Income-tax Act , 1961(see section 6) and the legal status of the application of internal tax law of residence state or source state (see section 7). Further, this paper analysis the overall positioning of various literature on the treaty (also referred to as "Double Taxation Avoidance Agreement" or "DTAA") interpretation very briefly.

1. Article 3(2) of OECD MTC: Extract from the OECD MTC, 2017

"As regards the application of the Convention at any time by a Contracting State, any term not defined therein shall, unless the context otherwise requires or the competent authorities agree to a different meaning pursuant to the provisions of Article 25, have the meaning that it has at that time under the law of that State for the purposes of the taxes to which the Convention applies, any meaning under the applicable tax laws of that State prevailing over a meaning given to the term under other laws of that State."

2. Article 3(2) of OECD MTC: Undefined treaty terms - Interpretive Issues

There could be the following interpretative issues[3] for undefined treaty terms:

1. Does the reference to undefined terms refer only to words or does it refer to clauses, expressions and concepts?
2. Does the provision direct reference only to internal tax law terms that are identical or does it permit reference to similar terms?
3. Does this clause direct the use of internal law concepts to provide meaning to undefined terms used in treaty definitions themselves?
4. When does the treaty's context "require" the use of a contextually derived meaning rather than a reference to internal tax law?
5. When internal law concepts are appropriately used i.e., the relevant internal tax law at the time the treaty was concluded or does it incorporate post-execution changes in the internal tax law?
6. Whose internal tax law definition should be used?

3. Article 3(2) of OECD MTC: Relevance of "Context"

- The term "context" as used in Article 3(2) of OECD MTC seems to have a broader meaning than the context mentioned in Article 31(1) of the VCLT.

- Article 3(2) of OECD MTC read with commentary at Para 12 says that context will prevail. For a particular term used in the DTAA which is either defined or not defined therein, the following steps need to be considered:
  - **Step 1:** If the term has been defined in the DTAA itself that is the meaning which will be followed.
  - **Step 2:** If the term has not to be defined in the DTAA, we will first look at the context.
- The context will be decided based on the intention of the contracting state while signing the convention.
- Reference to domestic law is required unless the context requires otherwise and where the context requires otherwise, then we have to follow the context as per the VCLT. Thus, the domestic law definition can be applied where the context does not require an alternate interpretation.
- Context seeks the common meaning which can otherwise be misinterpreted differently in both the contracting state.
- How broad the context should be is a matter of conjecture, however, too broad a context would lead to contradictory results.
- How to define the "context": There are three types of context as follows:

Type of Context	The intrinsic context	The primary extrinsic context	The secondary extrinsic context
VCLT – Article Number	31(2)	31(3)	32
Explanation	This covers all textual elements inextricably linked to the treaty (including the treaty text, preamble, annexure, protocols, subsequent agreements concluded by the contracting states and the materials prepared in connection with the convention).	This is evidenced in mutual agreement procedures, practices followed by the states in connection to the treaty and similar treaties (covering not only other tax treaties but also non-tax treaties).	This is the broadest of the three, including decisions by third states case law, Model convention commentaries, preparatory works, unilateral statements about the intention of the parties regarding the treaty being interpreted, including all facts and circumstances surrounding the signing of the interpreted treaty.

4. Article 3(2) of OECD: Debate between Special Rule of Interpretation and General Rule of Interpretation (Relationship between Article 3(2) of OECD MTC, 2017 with Article 31 and Article 32 of VCLT)

- As a special rule of interpretation, Article 3(2) of OECD MTC may have a priority over the general rule.
- That said, the meaning of the words used in Article 3(2) of OECD MTC are themselves to be interpreted in accordance with the principles set out in Article 31 of the VCLT. Thus, a special rule is still subject to the general rule.
- Thus, in applying the provisions of DTAA, as regards undefined terms, the right of a contracting state to use the ordinary meaning that the appropriate time has under domestic law is subject to the general requirement of good faith and the need to have regard to the object and purpose of the DTAA.
- Throughout the OECD MTC, the words '**shall**' and '**may**' are used deliberately to indicate mandatory and permissive provisions.
- The use of the word '**shall**' in Article 3(2) of

Article	Para	Explanations
3(2)	13.1	Where there is a tax and non-tax definition of that term in multiple types of domestic law, the tax definition will be preferred.
3(2)	13.2	If an agreement has been reached by the competent authority of the contracting state in respect of the meaning of the term, then domestic law meaning shall not apply.
Introduction of OECD MTC	35	An ambulatory approach to the interpretation of the term will apply.

OECD MTC suggests a mandatory requirement to apply domestic law in the case of undefined terms unless the context otherwise requires.

- The word "**required**" in the phrase 'unless the context otherwise requires' means:

  \- that "*all possibly reasonable interpretation from the context should not give rise to a deviation from the rule of Article 3(2) of OECD MTC but only those backed by particularly robust arguments.*[4]"

5. Article 3(2) of OECD MTC: Interplay with India's Income-tax Act, 1961

5.1. Relevance of Domestic law

- Domestic law definition can be applied when,
  - The context does not require an alternate interpretation (otherwise) or
  - The contracting state has not agreed to any special meaning under Article 25 of OCED MTC.
- Where the context is uncertain (unconcluded) and no agreement between the contracting state about the meaning of the term, then the domestic law definition will apply.
- Salient features in OECD commentary:
- Reference to the internal tax law of each contracting state can result in either double taxation or double exemption.

5.2. Approaches in Interpretation of Terms

- When a DTAA refers to the provision of the domestic laws of a contracting state for assigning meaning to a particular term and subsequently the domestic law is changed, then the question arises for assigning meaning for that term:

  (a) Whether the DTAA intends to assign the meaning which was prevailing in the domestic law of the contracting state at the date of signing the DTAA (a static interpretation) or

  (b) The meaning of the date of application of the DTAA (an ambulatory interpretation)?

- The Ambulatory approach is also referred to as the dynamic approach to the interpretation of a DTAA subject to contextual interpretation: An ambulatory interpretation is now explicitly called for by the Commentary of OECD MTC when the context does not require otherwise.
- An ambulatory approach cannot be applied when there is an underlying amendment in the domestic law thereby altering the sum and substance of the term. In such a case, the ambulatory approach allows a contracting state to unilaterally change its domestic law which resulted in the overriding DTAA.
- If the ambulatory interpretation adopted by a contracting state is not accepted by the other contracting state then recourse to the mutual agreement procedure is needed.

5.3. Meaning of Terms not defined in the DTAA

- If a particular term is not defined in the DTAA, its meaning can be ascertained with reference to the domestic tax laws of the source state.

- If a particular term is not defined in the domestic tax laws of the source state, then the term would be interpreted as per the general law of the source state.
- **Income-tax Act, 1961: Sub-section (3) of section 90**
  - Provides that any term used but not defined in the Act or in DTAA shall have the same meaning as assigned to it in the notification issued by the Central Government.
  - The only saving grace here is that the term so defined must be in the context of the relevant provision and should not be inconsistent with provisions of the Act or relevant DTAA.
- **Income-tax Act, 1961: Explanation 3 to section 90**
  - It clarifies that where any term is defined by the Government notification, it shall be deemed to have such a meaning assigned from the date on which the relevant DTAA comes into force (in respect of which such term is notified).

> *"Tax treaties signed by India with certain countries such as Armenia, Sudan, Hungary, Kazakhstan, Portugal, South Africa etc., specifically adopt ambulatory approach in their respective Tax Treaties i.e., terms not defined under the Tax Treaty should be given a meaning as per the domestic tax law prevalent at the relevant point of time. Hence, the amendment to section 90(3) may be considered to be in conflict with the provisions of such Tax Treaties."*

- **Income-tax Act, 1961: Explanation 4 to section 90**
  - It clarifies that where any term used in a DTAA is defined under the said double tax avoidance agreement, the said term shall have the same meaning as assigned to it in the DTAA; and
  - Where the term is not defined in the said DTAA but defined in the Act, it shall have the same meaning as assigned to it in the Act and explanation given to it by the Central Government.

5.4. **Interpretation of DTAA terms: International context prevails over the domestic definition**

- Article 3(2) of OECD MTC is unclear as to whether domestic law concepts or rather an interpretation from the context of the treaty should prevail. There are two opinions in this regard as follows:

  Opinion 1: An interpretation from the context of the treaty is warranted.

  Opinion 2: Others deem instant recourse to domestic law preferable.

- A term used in DTAA's between countries which is contradictory with their domestic legal systems, its meaning should be ascertained with reference to international meaning and it should be consistent with the international fiscal rather than a meaning which is dependent on the domestic law of one of the contracting parties.

6. Article 3(2) of OECD MTC: Internal tax law: Whose?

- The expression 'application' creates a debate that whose internal tax law should apply i.e., residence state or source state.
- There is no necessity under the treaty for one state to take up the interpretation given to a term in the other state because the such line of thought is not consonant with the object and purpose of tax treaties.
- The ordinary meaning of the word "**application**" is '*doing something as a result of the treaty which it would not do under internal law… what it does not mean is that the state has merely read the treaty to see what it is allowed to do.*'[5]
- There are mixed views on using the internal tax law of the source state or residence state as follows:

Particulars	Source state	Residence state
Preference for Internal tax law given by	Avery Jones	Professor Vogel and Dr. Rainer G. Prokisch
Contention given	• Recognizing the source jurisdiction. • Only the source jurisdiction would be "applying" this provision and the only provision the residence jurisdiction would apply "as it affects itself".	• Residence jurisdiction must itself apply the provisions to determine whether the source jurisdiction's taxation is in accordance with the DTAA.[6]

- The phrase '**in accordance with….**' provides two possible purposive interpretations:
  1. Favors the source jurisdiction and limits the residence jurisdiction's Article 23 of OECD MTC inquiry to determine whether the source jurisdiction had the right to tax.
  2. Favors the residence jurisdiction and permits the residence jurisdiction to independently characterize the income to preserve its understanding of the DTAA.
- In the case of Boulez v. Commissioner[7], it was held that there would seem to be no reasoned basis for favoring the source jurisdiction's characterization at the expense of the residence jurisdiction's characterization.
- Article 3(2) of OECD MTC could be used to give an interpretation of the single contracting state at a given point in time, it cannot be regarded as a rule to arbitrate the difference between the divergence of the interpretation. In that case, we need to use either Article 25(3) of OECD MTC if the parties so agree[8] or else we have to follow Article 31 of VCLT.

7. Overall positioning of various literature in the treaty interpretation

There are various range of extrinsic aids to interpretation of a tax treaty which can be divided into two aids of interpretation:

7.1. **Primary aids:** VCLT of 23.05.1969 is particularly related to the interpretation of tax treaties.

Sl. No.	Primary aids	Explanation
8.1.1.	VCLT	VCLT set outs and explains the general rules of guidance for the interpretation of the treaty through Article 31 to Article 33 of the VCLT. • General rule of interpretation [Article 31 of VCLT]. • Supplementary means of interpretation [Article 32 of VCLT]. • Interpretation of the treaties authenticated in two or more language [Article 33 of VCLT].

7.2. **Secondary aids**:

Sl. No.	Secondary aids	Explanation
8.2.1.	Commentary to OECD MTC	• It is neither binding nor has the force of law. • It does not fit within Article 31(2)(b) of VCLT. • It can also come under Article 32 of VCLT. • Para 29 of OECD Commentary on Introduction provides that commentary can be used as an interpretation of the treaty.
8.2.2.	Protocol	• It is an integral part of a tax treaty and has the same binding force as the main clauses therein.[9]

Sl. No.	Secondary aids	Explanation
8.2.3.	International Articles/ Reports/ Essays/Expert opinion	• It is a useful material for the interpretation of tax treaty.[10] • It is only persuasive in nature.
8.2.4.	Preamble	• Preamble to tax treaty could guide in the interpretation of a tax treaty.
8.2.5.	Parallel treaties	• It is also referred to as aids to treaty interpretation but their value will be generally below.[11]
8.2.6.	Memorandum prepared by the tax authority of a contracting state outlining the reason for adopting a particular technical position	• It does not satisfy the requirement of Article 31(2)(b) of VCLT. • It is not within the "context" envisaged under Article 31 of VCLT nor accompanying materials under Article 32 of VCLT.
8.2.7.	Domestic law definition	• Assuming there is no definition of the term or phrase given in the domestic law and there is no indication in the double tax avoidance agreement that domestic definition has to be accepted. • In that situation, Article 3(2) of the DTAA can be used.
.2.8.	Foreign Court Ruling	• It is best viewed in the context of making the interpretation that is in line with the "object and purpose" of the treaty. It is only persuasive in nature. • It should be agreed to both the contracting state & also, the rank of foreign court needs to be looked into.

Conclusion

There are many issues pertaining to the application and interpretation of undefined terms in double tax agreements, however, Article 3(2) OECD MTC is to be interpreted in accordance with the general principles of interpretation in international law and reference to the domestic law is required unless the context requires otherwise and where the context requires otherwise, then we have to follow the context as per the VCLT. Preference for the ambulatory approach has been given subject to contextual interpretation while interpretation of the DTAA. Therefore, while interpreting a DTAA, an extensive interpretation should be exercised. Terms in DTAA's often appear to be left open as contracting states plan on addressing disputed points when they arise and reserving the best possible bargaining position in negotiations between their respective administrative authorities.

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Digital Economy Taxation in India

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Before plunging right into technicalities of the topic, it is worth while to understand various new terminologies coined and very much pervasive in our day to day lives in one way or the other. New Economy or Digital economy[i] or internet/web economy through which e-commerce transaction are facilitated over electronic platforms carry one and the same message so far as it is concerned with taxation of a digital business. An online transaction carried out making use of computer/mobiles i.e. Internet Communication Technologies (ICT) with minimum or virtually negligible human intervention is known as digital or new economy.

The pandemic has disrupted the businesses and commerce across the board like never before. However, some of the industries like entertainment, hospitality, travel and tourism including reality and retail sectors faced most of the brunt. Even during such testing times, we all witnessed one common thing i.e. the digital mode of doing business accelerated further and digital economy with the help of ICT came to our rescue in terms of business sustenance, meeting day-to-day consumer essential needs by harnessing technology and enabling contactless order placement and supply and making the payments. Digital Economy is now a well-accepted new normal of doing business regardless of geography. It is raising concerns on global consensus for due fair taxation instead of double or non-taxation.

Growing importance of digital economy

As per an industry estimate[ii], India's consumer digital economy is set to become US$800 billion market by 2030 i.e., expected to have a 10X growth[iii] from current levels. It is estimated that more than 70% businesses will switch to digital modes, which among other, includes Fintech, online gaming, etc.

It is because of digital economy that today practically each aspect of business can be operated via online mode. There is no need to have any physical space to start a new business i.e. one can conduct a business dealing in products or services digitally regardless of geo-location. In today's time, we can easily witness real-life examples of global business' presence without physical presence, for example, we are inundated with global giants dealing in Cab services, hotel rooms and food deliveries without actually owning the business in traditional bricks and mortar system (traditional location-based business presence models) but through digital economy mode by controlling online platform/deliveries that too just on a click of a button.

Taxation of cross-border transactions

Now let us understand how a non-resident business gets tax liable in India. For this, we will have to refer to sections 5, 6 and section 9 of the domestic income tax act 1961("the Act'') dealing with scope, residential status and business, connection including deeming fiction on the total income of a non-resident business entity as well as provisions of Double Taxation Avoidance Agreement ('DTAA'). For taxation, a resident business is taxed on its worldwide income, whereas a non-resident business is taxed only on its income sourced in India. A company will become tax resident in India on satisfying either of the conditions: (a) Registered in India and (b) Place of Effective Management (POEM) is in India. Accordingly, a company incorporated outside India and having its POEM outside India is considered as a non-resident.

Under DTAA treaties, business profits are attributed to a Permanent Establishment (PE) as if it is a distinct and separate entity as per the provisions of Article 5 read with Article 7 of a DTAA. Such business profits can be taxed only if there exists a business connection or a PE in India at the rate of 40 per cent on net basis, unless the income qualifies as royalty or Fees for Technical Services (FTS) which will be taxed at a rate of 10 % on gross basis. Further, as per the provisions of section 90(2) of the Act, a non-resident will be entitled to claim beneficial provisions between the Act and DTAA.

Key considerations to address the tax concerns related to digital economy are as under:

1. Characterisation of income i.e. Business income vs Other Passive Income.
2. Business Nexus for taxing right if a PE existence.
3. Business Income Allocation basis.

Background to India's Unilateral Digital Tax Measures

> **It is because of digital economy that today practically each aspect of business can be operated via online mode.**

The Organisation for Economic Co-operation and Development (OECD) published an Action Plan on Base Erosion and Profit Shifting (BEPS) in July 2013 followed by a final report published in 2015 with 15 Action Plans. BEPS project was intended to curb tax evasion and double non-taxation due to some lacunas in tax rules artificially shifting profits to low or no-tax jurisdictions. The first action out of the 15 Action plans, Action Plan 1 dealt with addressing challenges thrown by digital economy taxation. Action Plan 1 analysed and suggested a few possible options as under:

1. Equalization Levy
2. Withholding tax on certain digital transactions
3. Nexus based approach

Considering that consensus on the matter will be take 4-5 years, the OECD suggested that member countries can adopt any of the aforesaid options in their domestic tax regime to prevent domestic tax leakages with the conditions that DTAA will be respected. CBDT, the apex direct tax board in India carried the baton by instructing to set up a committee on the taxation of e-commerce to evaluate the taxation of digital economy.

A. **Equalization Levy-** It was recommended that equalisation levy[iv] (EL) as a viable option, as it did not require alternation in the existing tax treaties and India became one of the first countries to levy EL@ 6% on online advertising and related services effective 1st June 2016. It was further widened in 2020 by bringing within its ambit the EL 2.0 i.e. to cover online sale of goods and services levy EL taxable@ 2%.

   It is important to note that EL is outside the ambit of the Income-tax Act, 1961, it is unilateral step in the domestic law that too by the Finance Act 2016 and not in the Income-tax law. Tax treaties are mutual agreements by two sovereign nations who agree to execute it for mutual welfare of the states, therefore it affects DTAA applicability. One view is that by keeping EL outside the Income-tax Act, 1961 the benefits of the DTAA (which are made effective due to incorporation under the Act) are denied. TDS u/s 195 not applicable on payments covered by EL due to exemption u/s10 (50). In case a non-resident e-commerce operator has a PE in India, then normal domestic IT provisions and relevant DTAA will be applicable. Liability to pay EL2.0 is cast on the non-resident 'e-commerce operator', whereas resident payer to deduct and pay EL @6% on online advertisements. If EL@ 6% applies (subject to a threshold of INR 1 lakhs), then EL2.0 @ 2% shall not apply. NO EL@2% will apply if sales turnover or gross receipts of the e-commerce operator from supply of goods or services do not exceed ₹ 2 crores in the year

B. **TDS on e-Commerce transactions-** Effective 1st Oct 2020, the IT Act mandated to apply TDS vide newly inserted section 194-O @ 1% by resident e-commerce platform/ operator/ on Gross Value of Sales made by e-commerce participants. E-Commerce participant means that a person resident in India selling goods or providing services or both, including digital products, through digital or electronic facility or platform for e-commerce;

(i) TDS rate will be @ **5% if PAN not available**.

(ii) No TDS deduction u/s 194O if TDS is being deducted under any other section by the payer.

(iii) No threshold limit for corporate e-commerce participant but available for individual and HUF up to ₹ 5 Lakhs.

C. **Towards nexus approach-** Significant Economic Presence **(SEP)** provisions in the domestic tax law have significantly widened the scope of the term 'business connection' applicable from FY 2021-22. SEP[v] provisions deferred to AY 2022-23 and EL provisions were expanded in the meantime to tax non-resident e-commerce operators through EL 2.0. India waited for a couple of years to come out with above-mentioned threshold to activate the SEP provisions. The idea was to develop a consensus amongst OECD nations by the end of December 2020.

A non-resident having SEP in India shall be deemed to have a business connection in India and would be taxable in India, **irrespective of whether**

a) agreement for such transactions or activities is entered in India; or

b) non-resident has a residence or place of business in India; or

c) non-resident renders services in India.

SEP of a non-resident would be established if:

(i) the aggregate of payments arising from transactions in respect of any goods, services or property carried out by a non-resident with any person in India including provision of downloading the data or software in India, during the financial year exceeds Rs. 20 Mn (during a financial year); or

(ii) Non-resident undertakes systematic and continuous soliciting of business activities or engages in interaction with 300,000 or more number of users in India.

> **Significant Economic Presence (SEP) provisions in the domestic tax law have significantly widened the scope of the term 'business connection' applicable from FY 2021-22.**

Challenges in Implementation of Unilateral measures

1. The business connection definition sought to expand through SEP is leads to ambiguities in the form of unintended coverage of physical goods or intangible properties, although these are sought to tax digital business activities.

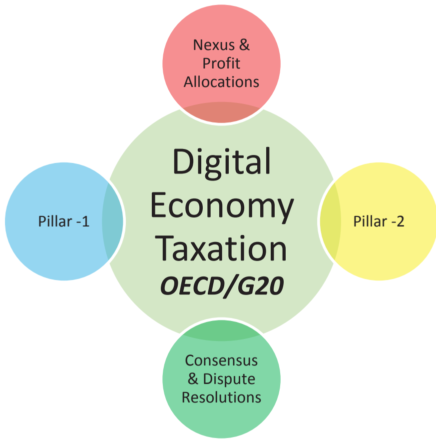
2. As per the currently worded definition of EL and SEP in law, one has to analyse the SEP explanations carefully and the interplay between EL and SEP. It has some overlapping as well, particularly for transactions with countries where we do not have Double Tax Avoidance Agreement. Therefore, one should correctly categorize an income either under SEP or subjected to EL, as tax consequences are onerous, especially the TDS.

3. The lack of clear-cut definitions and meanings of the terminologies used in defining coverage of EL and SEP may lead to gross confusion and impact the smooth implementation and intent of the legislatures. For example, systematic, continuous and soliciting have not been defined and thus are subject to more than one interpretation. The term 'user' is ambiguous, as it has not made out explicitly, whether the user includes only active users or passive users like click-based user, viewer, subscriber, etc. The clauses (a) & (b) to the explanation are separated by Or, thus, these are not to be read in conjunction with each other is another cause of concern for the meaningful implementations.

4. Unilateral domestic tax measures in EL and SEP in the IT Act1961 don't affect DTAAs principles unless corresponding changes are reflected in respective DTAAs.

5. The new data protection law (which is in the offing as of now) will also have a significant bearing on the taxability of the digital economy, as data localisation is one of the law's prerequisite. It is understood that local data will have PE implications for any non-resident.

OECD Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalization of the Economy



The OECD along with the G20 nations felt the need of taxing digital economy. It initiated steps towards working framework for taxation of digital economy way back in 2015 through special project titled Base Erosion and Profit Shifting (**"BEPS"**) Project. OECD a global organization has been working tirelessly to come up with consensus with all participating member countries for common agreed approach for the taxation of the digital economy.

Out of total 15 action plans, the first action plan, Action-1, is dedicated to address the Tax Challenges of the Digital Economy. It was initiated in the year 2015 but could not reach consensus due to complex nature of digital economy involving multi-dimensional issue of taxing digital economy until October 2020. Recently, OECD/G20 efforts brought real fruits in BEPS 2.0. A key part of the BEPS Project is to address the tax challenges arising from the digitalisation of the economy. In October 2021, over 135 jurisdictions joined hands and agreed to work together to find solution to this global phenomena. On October 8, 2021, the Inclusive Framework (IF) issued statement for an agreement on a two-pillar solution to address the tax challenges arising from the digitalisation of the economy.

> **"The lack of clear-cut definitions and meanings of the terminologies used in defining coverage of EL and SEP may lead to gross confusion and impact the smooth implementation and intent of the legislatures."**

Pillar One revisits profits allocation[vi] along with nexus rules for aligning taxing rights more closely with local market engagement. A portion of the residual profit of the largest and most profitable groups is allocated to end market jurisdictions irrespective of any physical presence in those jurisdictions, where goods or services are used or consumed.

It will apply to groups with greater than € 20 billion turnover globally and a profitability before tax (PBT) in excess of 10% calculated using an averaging mechanism. Going forward it is intended to lower down the revenue threshold to € 10 billion after seven years, subject to successful implementation of Pillar-1.

- **Amount A:** It will be calculated @25% over and above 10% of residual profit before tax to the source market jurisdictions if it has at least €1 million in revenue (reduced to €250,000 for jurisdictions with GDP less than €40 billion based on a formula). The allocation rules will follow soon and formula is not the arm's-length principle.
- **Amount B:** This would represent calculation of remuneration in respect of marketing and distribution function in the source jurisdiction. As of now, it has been deferred pending further technical work, which is expected to complete by the end of 2022.

It aims tax certainty through effective dispute prevention and resolutions applicable to all businesses. The Inclusive Framework (IF) provided more certainty with respect to Pillar-1, but many details are yet to see light of the day, for example multilateral convention would be a perquisite to implement Pillar-1, which is expected to take effect beginning in 2023.

Illustration

Facts: A Inc. has a local subsidiary S Co 1 (Market 1) in tax efficient jurisdiction. S Co 1 earns revenues domestic Market and from overseas markets, say Market 2 and Market 3. The company has no physical presence in Market 2 and Market 3 where services are supplied digitally.

Assumptions:

- The total group revenue exceeds the threshold of € 20Bn;
- It is assumed that Group A is treated as one segment for Amount A purposes and it has PBT of € 7,000Mn.

The revenue and source market jurisdiction is as follows:

Market Jurisdiction	Revenue in Mn (€)
Market-1	2000
Market-2	20000
Market-3	6000
Total	**28000**
EBT Margin	**25%**
PBT	**7000**

Now, we will apply formula to arrive at Amount A as under-

Step 1: Determining Group A's residual profit (W) by subtracting profit threshold of 10%:

W = 7,000 – (28,000*10%) W = 4,200

Step 2: Determining the quantum of profit to be allocated (25% of W):

4200*25% = 1050

Step 3: Allocation

Market Jurisdiction	Revenue in Mn (€)	Amount A (1050/28000 * Revenue)
Market-1	2000	75
Market-2	20000	750
Market-3	6000	225
Total	**28000**	**1,050**
EBT Margin	**25%**	
PBT	**7000**	

Pillar-2 establishes a global minimum taxation regime through a series of interlocking rules. On December 20, 2021, the IF released Model Global Anti-Base Erosion[vii] (GloBE) rules (Model Rules). These Model rule apply to Multinational Enterprise (MNE) groups with total consolidated group revenue of above €750 million in at least two of the four preceding years. Governmental entities and pension funds are generally excluded from the GloBE rules. It is relying on Country-by-country reporting(CbCR) mechanism and concepts for determining constituent entity further, GloBE Rules do not compel any country to adopt a minimum tax rate. If source country does not levy tax at agreed minimum rate, then the other jurisdiction would have the right to tax.

Pillar-2 revolves around **3 main rules providing jurisdictions additional taxing rights. It includes** Two interlocking domestic rules:-

(i) **Income Inclusion Rule (IIR)**, it imposes top-up tax on a parent entity in respect of the income of subsidiaries and permanent establishments that is taxed at less than a 15% minimum effective tax rate, and

(ii) **Undertaxed Payment Rule (UTPR)**, it denies deductions or requires an equivalent adjustment in an event i.e. a parent entity's allocable share of the top-up tax regarding a low-taxed constituent entity is not subject to tax **under an IIR.**

(iii) **Subject to Tax Rule (STTR)**, it overrides treaty benefits related-party payments (including interest and royalties) that are not subject to a 9% minimum rate of tax in the recipient jurisdiction. The STTR will be creditable as a covered tax under the IIR and UTPR, i.e., the STTR applies first. IF members are not obliged to adopt the IIR and UTPR but must accept the application of the rules by other IF members.

The Road Ahead

Taxation is evolving with the changes in business models. The situation gets convoluted when digital economy kicks in through business activities carried out by means of online platforms enabled by Internet Communication Technologies (ICT) with no server /database in India and no physical presence. It would be interesting to witness and decipher at the same time how the new taxation principles would evolve to become an effective and efficient taxation system.

The OECD initiative through Pillar 1 and Pillar 2 will bear fruit only when there is global consensus on income characterisation and monetary threshold application. It would be interesting to see how unilateral measures to tax Digital services would be replaced with a two-pillar approach. It is therefore advised to first to understand the underline business model and then apply the taxation principles as it is said that one size doesn't fit all. Still everyone has to pay their due share of tax to the coffers of governments to sustain welfare activities of the nations.

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GST

Intricacies revolving around liquidated damages taxability under GST

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Damages awarded pursuant to a contract are quite prevalent in day-to-day transactions undertaken by business entities. Since the quantum of damage borne by defaulting party may be huge, one has to be mindful of the tax controversies revolving around the taxability under the Goods and Services tax Act. There is a plethora of contradictory judgements on the tax implications in the erstwhile Service tax regime and GST law. It is evident from the Advance rulings pronounced under the GST that the authority has not taken into consideration the fact whether the damages paid pursuant to a contract would qualify as a 'supply' under GST which is the taxing event.

In common parlance of trade, before executing any transaction, parties enter into a legal contract wherein the rights and obligations of both the parties are clearly laid down. The basic structure of the contract is governed by the Indian Contract Act, 1872 which highlights the provisions relating to performance, non-performance and the breach of contract.

Going by the literal understanding of the word 'damage', it is a remedy in the form of monetary reward paid to a claimant as compensation to loss or injury. Black's Law Dictionary defines damage as under:

"A pecuniary compensation or indemnity, which may be recovered in the courts by any person who has suffered loss, detriment, or injury, whether to his person, property, or rights, through the unlawful act or omission or negligence of another."

Indian Contract Act clearly provides for compensation[1] for loss or damage caused by breach of contract to the affected party. Such damages may be a pre-estimated damage which the parties agree while making the contract or may be left to be decided by court on basis of assessment of loss or injury.

The Black's Law Dictionary defines the terms as under:

Liquidated Damages

"An amount contractually stipulated as a reasonable estimation of actual damages to be recovered by one party if the other party breaches; also if the parties to a contract have agreed on Liquidated Damages, the sum fixed is the measure of damages for a breach, whether it exceeds or falls short of the actual damages."

Unliquidated Damages

"Damages that cannot be determined by a fixed formula and must be established by a judge or jury."

Having set the context of the importance of the term damage, its significance in the contract, let us deep dive into the intricacies which revolve around taxability of such damages under the indirect tax laws.

[1] *Section 73 and 74 of the Indian Contract Act*

Provisions under the Central Goods and Services Tax Act, 2017 ('the CGST Act')

- With effect from 1 July 2017, GST is applicable on supply of goods or services or both. The term **"Supply"** has been defined[2] as under:

  "(1) For the purposes of this Act, the expression "supply" includes––

(a) *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;*

  ……..

  *(1A) where certain activities or transactions constitute a supply in accordance with the provisions of sub-section (1), they shall be treated either as supply of goods or supply of services as referred to in Schedule II.***"**

- Schedule II to the CGST Act which lists out certain activities to be treated as supply of goods or supply of services specifically provides in Para 5(e) as under:

  "(5) The following shall be treated as supply of services, namely:

  (e) agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act;"

- The aforementioned terms have not been defined under the CGST Act, however, same were explained in detail by Maharashtra Appellate Authority for Advance Ruling[3] as under:

  - **Refrain from act:** An agreement for non-compete with each other.

    For example: Sale of brand name by X to Y where X agree that he will not sell similar product under any other brand in the market for a specified number of years. In this case, as per the contract, X specifically refrain himself from acting (selling) the product.

  - **Tolerate an act or situation :** The person or institution may agree to tolerate an act of others. Toleration is defined in Black's Law Dictionary (Tenth Edition) as

    "The act or practice of permitting or enduring something not wholly approved of; the act or practice of allowing something in a way that does not hinder."

    For example:

    In a society, for work to be permitted to be carried in the lift during a particular time etc., society charges the person carrying out the repair for the inconvenience caused to other members. This, in commercial term, is known as

    "hardship amount". In such situation, the members agree to tolerate the act carried out by other person. This benefits the society in the form of certain considerations.

  - **To do an act:** Service provider may sometimes agree for doing a particular act for which he receives payment.

    For example: The retailers enter into agreement with the companies that they will sell the cold drink of particular brand of the Company, and he will not sell the cold drink of other company. In such case, retailers agree to act in a particular manner for which he is paid the amount.

- Since supply is undertaken for a consideration, one may refer to the definition of 'Consideration' which in relation to supply of goods or services includes:

  "(a) any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government;

  (b) the monetary value of any act or forbearance, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether

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[2] *Section 7 of the CGST Act*

[3] *Order No.MAH/AAAR/SS-RJ/09/2018-19*

by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government"

- In terms of Notification no. 12/2017 – CT (Rate), exemption is provided on the 'Services provided by the Central Government, State Government, Union territory or local authority by way of tolerating non-performance of a contract for which consideration in the form of fines or liquidated damages is payable to the Central Government, State Government, Union territory or local authority under such contract'.
- The above notification exempts taxability of damages in case of government contracts, opening a pandora box of interpretation for usual contract between business entities.
- There is a plethora of advance rulings under GST which held liquidated damages to be taxable under GST. However, it would be worthwhile to analyse the guidelines and precedence set in the erstwhile Service tax law since the similar provision existed under earlier laws as well.

Analysis of provisions of the erstwhile law and judicial precedents

- Service law was leviable on provision of service, which means an activity for consideration carried out by one person for another.

The term was explained in "Taxation of Services: An Education Guide"[4] as under:

The concept 'activity for a consideration' involves an element of contractual relationship wherein the person doing an activity does so at the desire of the person for whom the activity is done in exchange for a consideration. An activity done without such a relationship i.e., without the express or implied contractual reciprocity of a consideration would not be an 'activity for consideration' even though such an activity may lead to accrual of gains to the person carrying out the activity.

- It is a well settled law that mere flow of money cannot be a subject matter of service tax and consideration should have 'nexus' with an identified supply of service.
- Reliance may be placed to decision of Hon'ble CESTAT in the case of Cricket Club of India v. Commissioner of Service Tax[5] wherein such nexus was clearly laid down. A relevant extract is enumerated below:

'......Neither can monetary contribution of the individuals that is not attributable to an identifiable activity be deemed to be a consideration that is liable to be taxed merely because club or association is the recipient of that contribution.'

- Similar view on the consideration was taken in the matter of Mormugao Port Trust v. Commissioner of Customs, Central Excise and Service Tax, Goa[6]

"…In our view, in order to render a transaction liable for service tax, the nexus between the consideration agreed and the services activity to be undertaken should be direct and clear. Unless, it can be established that a specific amount has been agreed upon as a quid pro quo for undertaking any particular activity by a partner, it cannot be assumed that there was a consideration agreed upon for any specific activity so as to constitute a service."

- *Given aforementioned legal provisions and judicial precedents, it is evident that it is a well settled law that mere receipt of money would not tantamount to consideration. Unless and until consideration is flowing at the desire of the party for undertaking a particular activity, same would not qualify as consideration.*

Judicial Precedents

In the Service laws, various judgements have held that liquidated damages shall not be taxable. Some of these are given below:

- In M/S South Eastern Coalfields Ltd. Versus Commissioner of Central Excise and Service Tax, Raipur[7], Hon'ble CESTAT took the following grounds while deciding penalties paid by defaulting parties on account of breach of contract would not be taxable.
  - *There is a marked distinction between 'conditions to a contract' and 'consideration for the contract'. A service recipient may be required to fulfil certain conditions contained in the contract but that would not necessarily mean that this value would form part of the value of taxable services provided.*
  - *The purpose of imposing compensation or penalty is to ensure that the defaulting act is not undertaken or repeated and*

4. *Para 2.3 of Education Guide issued by CBEC*
5. *2015-VIL-549-CESTAT-MUM-ST*
6. *2015-VIL-607-CESTAT-MUM-ST*
7. *2020 (12) TMI 912 - CESTAT NEW DELHI*

the same cannot be said to be towards 'toleration' of the defaulting party.

- In M/S K.N. Food Industries Pvt. Ltd. Versus The Commissioner Of CGST & Central Excise, Kanpur[8], Hon'ble CESTAT held that:

  "liquidated damages were received to make good the losses or injuries from 'unintended' events and does not arise from any obligation on part of any of the parties. Hence, the same cannot be considered as the payments for any service."

- In Commissioner of Service Tax Vs. M/s. Repco Home Finance Ltd.[9], it was held:

  "Damages are to compensate for disruption of a service and not towards performance of the service. They should not be viewed as alternative mode of performance and accordingly, should not be subject to tax."

  On similar lines, we will come across multiple rulings decided in the favour of taxpayers denying taxability under Service tax.

Relevant judgement under GST regime

Under GST law, multiple Authority for Advance rulings while pronouncing their decision on taxability of liquidated damages under GST held:

"The empowerment to levy liquidated damages is for the reason that there had been a delay and the same would be tolerated, but for a price or damages.

The income though presented in the form of a deduction from the payments to be made to the contractor was the income of the applicant and would be a supply of 'service' by the applicant in terms of clause (e) of Para 5 of Schedule II appended to the Central Goods and Services Tax Act, 2017"

However, it is worthwhile to refer the judgement of Bombay High Court in the matter of **Bai Mamubai Trust and Ors. Vs. Suchitra**[10] which laid the basic ground rules for attracting GST on damages:

"The nature of "damages" for the purpose of GST held that compensation paid as damages for a violation of a legal obligation was not a supply under GST. The legal doctrine of supply did not include wrongful unilateral acts that resulted in the payment of damages.

The reciprocal obligations are essential to constitute supply and accordingly any payment in the nature of damages to balance equities between parties, in the absence of enforceable reciprocal obligations, would not constitute supply and would not attract GST."

Global precedence

One may take reference of the Global tax laws to understand the positions taken therein.

Under Australian GST law, different rulings issued by the Australian Tax Office[11] clarified damage or loss or injury does not constitute a supply.

Likewise, UK VAT instruction Manual[12] clarifies liquidated damages not to be a consideration for supplies and are outside the scope of VAT.

Entry 22.3 of VAT notice 708 issued by HM Revenue and Customs, UK highlights:

'Liquidated damages are agreed pre-estimated sums to be paid in the event of breach of a contract by one of the parties. If you receive liquidated damages, you are not receiving payment for a supply by you and no VAT is due on that amount.'

Conclusion

Aforementioned rulings clearly outline recovery of liquidated damages or penalty from other party cannot be said to be supply of service, as neither the receiving party is carrying on any activity to receive compensation nor there is any intention of the defaulting party to breach or violate the contract and suffer the loss.

The purpose of imposing compensation or penalty is governed by the provisions of Indian Contract Act to ensure the defaulting act is not undertaken or repeated. Same cannot be equated as receipt of consideration on account of toleration of an act.

Further, taking reference from the global tax laws, one may infer that the Indian GST provisions should be read in line with the positions taken across various countries as well as erstwhile Service tax law. The need of the hour is to streamline the provision relating to taxability of liquidated damages as it constitutes a significant amount of cost for industries engaged in the supply of exempted goods or services and hampering their ease of doing business.

"The purpose of imposing compensation or penalty is governed by the provisions of Indian Contract Act to ensure the defaulting act is not undertaken or repeated. Same cannot be equated as receipt of consideration on account of toleration of an act."

8. 2020 (1) TMI 6 - CESTAT ALLAHABAD
9. 2020 (7) TMI 472 - CESTAT CHENNAI
10. [2019] 109 taxmann.com 200/31 GSTL 193 (Bom.)
11. Australian Taxation Office, 'Goods and Services Tax: Supplies', Goods and Services Tax Ruling GSTR 2006/9
12. VATSC35600

The Institute of Chartered Accountants of India

COMMITTEE ON
MSME AND STARTUP

ICAI STARTUP GATEWAY

ICAI Startup SAMVAD

JANUARY
2023
4:30 pm to 7:30 pm

SAMVAD

Organised by:
The Committee on MSME & Startup, ICAI

Objective

The ICAI Startup Samvad Programme will be kicked off through the branches / RCs in January, 2023. The entire celebrations organised from 4:30 pm to 7:30 pm will be presented at large particularly for Startups, Investors, Mentors, Buddy Startups, Students, Chartered Accountants, Incubators, Innovators etc.

Purpose of this Startup Samvad Month Programme

To create awareness, increase the Startups Registration, Help in nurturing their ideas capacity building and provide assistance for developing Startup needs and boost in economy to achieve 5 Trillion dollar economy.

Knowledge Enhancement Sessions

3
CPE Hours

Technical Session on Startup: Topics:

- Introduction to Startup
- Go to Market Strategy
- How to Value Startup/ Startup Valuation
- Business Model-Case studies of Successful startup
- Startup Funding: Angel/ VC/Seed Funding

For more details, please visit:
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Export of Carbon Credit : Procedural disconnect in Refund Application

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Talks on Carbon credits have recently gained more importance as our Prime Minister Shri Narendra Modi has set an ambitious target of making India a net zero emitter by 2070. To achieve net zero carbon emission target, Indian government has introduced and passed the Energy Conversation (Amendment) Bill, 2022 in Lok Sabha on 8th August 2022. Currently, Indian companies are exporting UNFCCC-approved carbon credits which are sold through third-party regulator such as CDM formed under UNFCCC. On analysing the status of Carbon Credits as a supply of goods or services, scale is tilting towards the arguments that it's supply should be considered as supply of goods. But there lies a procedural disconnect while filing refund application as supply of such certificates is taking place electronically.

On 1st November 2021, the Prime Minister while delivering the National Statement at the COP26 Summit, in Glasgow, Scotland, set an ambitious target for India to attain net zero carbon emission by 2070.

This was a big news getting high publicity. Let us look at the brief history of this development and try to understand the key words which are of importance before we proceed to discuss the main topic of procedural disconnect during filing refund application on export of Carbon Credit.

Key Words

a) **United Nations Framework Convention on Climate Change (UNFCCC)** – *With 197 Parties, the UNFCCC has near universal membership and is the parent treaty of the 2015 Paris Climate Change Agreement. The UNFCCC is also the parent treaty of the 1997 Kyoto Protocol. The ultimate objective of all agreements under the UNFCCC is to stabilise greenhouse gas concentrations in the atmosphere at a level that will prevent dangerous human interference with the climate system, in a time frame which allows ecosystems to adapt naturally and enables sustainable development.*[1]

b) **Kyoto Protocol -** *The Kyoto Protocol operationalises the United Nations Framework Convention on Climate Change (UNFCCC) by committing industrialised countries and economies in transition to limit and reduce greenhouse gases (GHG) emissions in accordance with agreed individual targets.*[2]

   a. The Kyoto Protocol was adopted in Kyoto, Japan on 11 December 1997. Owing to a complex ratification process, it entered into force on 16 February 2005. Currently, there are 192 Parties to the Kyoto Protocol. Kyoto Protocol bounded only industrialised nations to act.

c) **Paris Climate Agreement –** *The main aim of the Paris Agreement is to keep the global average temperature rise in this century well below 2 degree Celsius and to drive efforts to limit the temperature increase even further to 1.5 degrees Celsius above pre-industrial levels.*[1] With the adoption of the Paris Agreement, most countries in the world have committed to climate action.

d) **Clean Development Mechanism (CDM) –** *The CDM was developed under the Kyoto Protocol. The CDM allows emission-reduction projects in developing countries to earn certified emission reduction (CER) credits, each equivalent to one tonne of CO2. These CERs can be traded and sold, and used by industrialised countries to* *meet a part of their emission reduction targets under the Kyoto Protocol.*

a. *The mechanism stimulates sustainable development and emission reductions, while giving industrialised countries some flexibility in how they meet their emission reduction limitation targets.*[3]

e) **Carbon Credit –** A carbon credit is a tradable certificate stating the credits earned by the holder of the certificate. Each credit is equivalent to 1 tonne of CO2 emission-reduction. These carbon credits can be used towards meeting Kyoto targets or used for voluntary purposes.

f) **Carbon Markets – Compliance & Voluntary Markets**

There are two types of carbon markets – the compliance market and the voluntary market.

- **Compliance Markets -** The compliance carbon markets are developed as part of a nation's obligation to cut their emission or bring it under a defined gap. The limit has been set up through global treaties like Kyoto Protocol. Under this, developed countries that are signatory to treaties like Kyoto Protocol must take steps to lower their emissions. This can be accomplished either through imposing carbon tax or setting up a mandatory carbon market. The allowances or permits that form the core of these markets are termed as Certified Emission Reduction (CER) credits.
- **Voluntary Markets -** Voluntary markets are those in which companies and other entities like government, NGOs, etc. take measures to reduce their carbon footprint as part of their own initiatives as a part of their CSR activities or to improve their reputation, etc. The credits in these markets are termed as Voluntary Emission Reduction (VER) credits.

India was a signatory to the Kyoto Protocol which bound only the industrialised nations to reduce greenhouse gases (GHG) emission and it provided targets for only the developed nations. Kyoto agreement was subsequently replaced by the Paris Agreement whereby almost all the nations of the world committed to reduce the GHG emission. In 26th Conference of Parties at UNFCCC i.e. COP26, India committed itself voluntarily to be net zero carbon emitter by 2070. To achieve net zero carbon emission target, Indian government has introduced and passed the Energy Conversation (Amendment) Bill, 2022 in Lok Sabha on 8th August, 2022. The bill seeks to establish Carbon Credit Market in India to issue Carbon Credit Certificates by Indian Government. Since this bill has not become an Act till date, we are not going to discuss the future of trading in Carbon Credit Certificates through Carbon Credit Markets. Currently, Indian companies are exporting UNFCCC-approved carbon credits which are sold through third-party regulator such as CDM formed under UNFCCC.

> **"A carbon credit is a tradable certificate stating the credits earned by the holder of the certificate. Each credit is equivalent to 1 tonne of CO2 emission-reduction."**

Let us look at the various issues and discuss the possible solutions in current scenario of trading of Carbon Credit Certificates.

Difference between tradable certificates and certificates issued by Authorities?

There are different types of certificates being issued by various Authorities. All the certificates issued are not termed as tradable certificates.

In the case of Venkatesh Automobiles, AAR Goa, the appellant was carrying out the Pollution testing and issuing Pollution Under Control (PUC) Certificate on payment of prescribed fees fixed by the Government. This issuance of certificate is supply of services unlike the tradable certificates like Renewable Energy Certificates (RECs) and Priority Sector Lending Certificates (PSLCs) which are held by CBIC as per circular no. 46/20/2018-GST, dt. 6th June, 2018 as goods.

Rate of GST on Tradable Certificates

Circular no. 46/20/2018-GST, dt. 6th June 2018 has further provided the rate of GST on Tradable certificates and duty paying scrips like MEIS, SEIS, etc.

Circular has also clarified that RECs, PSLCs are classifiable under following part of the entry having heading 4907 and attracting 12% GST. –

"Stock, share or bond certificates and similar documents of title [other than Duty Credit Scrips]",

Though duty paying scrips like MEIS, SEIS, etc. are classifiable under the same heading, it will attract Nil GST {under S. No. 122A of Notification No. 2/2017-Central Tax (Rate) dated 28.06.2017, as amended vide Notification No. 35/2017-Central Tax (Rate) dated 13.10.2017}.

> **The compliance carbon markets are developed as part of a nation's obligation to cut their emission or bring it under a defined gap.**

Whether Carbon Credits/Certified Emission Reduction (CER) credits will be termed as supply of goods?

a) Section 2(52) of CGST Act, 2017 defines goods and states that *"goods" means every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply;*

b) Key elements to be confirmed if a property is to be considered as goods under the GST Act are

- It should be a movable property
- It should not be money or securities
- Actionable claims are also good.

Note - Actionable claims, other than lottery, betting and gambling are considered as neither supply of goods nor a supply of services as per Schedule III of the CGST Act, 2017 and thus are outside the scope of GST. Meaning thereby that if CERs are termed as actionable claims, then it will be outside the scope of GST.

c) It should be noted that both in erstwhile Sales Tax Laws and Excise Laws, another element i.e. Whether property is marketable was to be considered while determining whether a property is goods or not.

Let us check these key elements one by one -

Whether CERs are movable property?

Concept of Movability was discussed in Municipal Corporation of Greater Mumbai-1996-SC and "test of permanency" was laid down which said –

(a) Whether the article is movable to another place of use in the **same condition**; or

(b) Is it liable to be **dismantled and re-erected** at another place?

If answer to the former is affirmative, it must be a movable property.

But if the answer to the latter is positive, then it would be treated as immovable property.

There is no doubt that certificates can be moved from one place to another in the same condition. Thus, CERs will be termed as movable property.

Whether carbon credits can be excluded from the definition of goods altogether by treating them as supply of securities or supply of money?

Whether Securities? – Let us read Section 2(h) of Securities Contract (Regulation) Act, 1956 (SCRA)**(relevant portion only)**,

"securities" include –

(i) *shares, scrips, stocks, bonds, debentures, debenture stock or other marketable securities of a like nature in or of any incorporated company or other body corporate;…..*

Analysts considering CERs as securities are including CERs within the scope of "other marketable securities of a like nature in or of any incorporated company or other body corporate" and stating that CERs can be considered as securities.

Also, to get judicial precedence for this argument, it is relevant to highlight here that renewable power companies have moved to Delhi High Court contending that RECs fall under the definition of securities, arguing that "These scrips are traded on IEX (Indian Energy Exchange) and PXIL (Power Exchange India Limited) and are electricity derivatives," and notices have been issued to the relevant parties.[4]

Whether Money?

As per Section 2(75) of the CGST Act, 2017, *"Money" means the Indian legal tender or any foreign currency, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller cheque, money order, postal or electronic remittance or any other instrument recognised by the Reserve Bank of India when used as a consideration to settle an obligation or exchange with Indian legal tender of another denomination but shall not include any currency that is held for its numismatic value;*

Since CERs does not come under any other instrument recognised by the RBI which can be used as a consideration to settle an obligation, thus CERs cannot come within the purview of Money.

Whether CERs can be considered as actionable claims?

Hon'ble Supreme Court in the case of M/s Vikas Sales Corporation (2) (1996) 4 SCC 433 while discussing whether REP Licence can be covered under Actionable claims, observed that: *"When these licences/scrips are being bought and sold freely in the market as goods and when they have a value of their own unrelated to the goods which can be imported thereunder, it is idle to contend that they are in the nature of actionable claims. It was assumed that actionable claims are not transferable for value and that was the difference between "actionable claims" and those other goods which are covered by the definition of "goods" in the Sales of Goods Act, 1930, and the sale tax laws. The assumption was fallacious and the conclusion in so far as it was based on this erroneous perception, equally wrong".*

Since CERs like REP Licences are being brought and sold freely in the market as goods and have a value of their own unrelated to any other goods, thus it cannot be considered as actionable claims.

Whether CERs are marketable?

In this respect, case laws of honourable Supreme Court and various high courts can be read to analyse whether CERs can be termed as marketable. The courts have not discussed whether CERs are marketable but have discussed whether other intangibles goods which are similar to CERs like, for example, copyright, patents, REP Licence, etc. It is relevant to read the judgement of the Hon'ble Supreme Court in the case of Tata Consultancy Services vs. State of Andhra Pradesh wherein, it was, inter alia, held that:-

"A "goods" may be tangible property or an intangible on. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold and (c) capable of being transmitted, transferred, delivered, stored and possessed. If a software whether customized or non-customized satisfies these attributes, the same would be goods".

Further, Hon'ble Supreme Court in the case of Yash Overseas vs. Commissioner of Sales Tax and Others (Civil Appeal No. 2155 of 2000), while discussing whether REP Licence was marketable or not, held that:

"REP licences had always a market. There were people willing to sell and others willing to buy REP licences at all times. Their innate value coupled with free transferability made REP licences into a marketable commodity. They were "goods" properly so called, having innate value and a ready market.

Under the Duty Entitlement Passbook (DEPB) Scheme, an exporter is eligible to claim credit as a specified percentage of the job value of exports made in freely convertible currency. The credit is available against such export products and at such rates as may be specified by the Director General of Foreign Trade by a public notice issued in this behalf. The DEPB is exactly the same as REP licence. Like the REP licence, it has an innate value which makes it a marketable commodity. The DEPB credit is also clearly "goods" within the meaning of the sales tax laws".

There is also a notification under DVAT Act (Notification No. 256/CDVAT/2009/43 dated 13-1-2010), which has discussed the levy of DVAT on CERs and after discussing the aforesaid mentioned rulings the department has concluded in the notification that the CERs will be considered as goods and will be taxable under DVAT Act, 2004. The DVAT Act has been replaced by SGST Act for all goods excluding alcoholic liquor for human consumption and 5 petroleum products i.e. Petroleum Crude, High Speed Diesel, Motor Spirit (commonly known as Petrol), Natural Gas and Aviation Turbine Fuel.

> **"Since CERs does not come under any other instrument recognised by the RBI which can be used as a consideration to settle an obligation, thus CERs cannot come within the purview of Money."**

Considering all the points discussed above we can conclude that the scale is tilting in the favour of the argument that sale of CERs will be considered as supply of goods under the GST as there is no judicial precedence to classify CERs and like tradable certificates as securities.

Export of Carbon Credits – Procedural Aspects

Since at present Indian market for exchange of carbon credits is not operating, in Indian scenario CERs can only be exported to industrialised countries.

What are certified emission reductions or CERs?

*Certified emission reductions or CERs are **electronic certificates** issued for greenhouse gas emission reductions from clean development mechanism (CDM) project activities or programmes of activities (PoAs)* *in accordance with the CDM rules and requirements. Each CER is equivalent to one metric tonne of carbon dioxide (CO2) avoided or removed from the atmosphere.*

The environmental benefit of CERs can be claimed to offset or compensate your own greenhouse gas emissions, among other uses.[5]

What does "voluntary cancellation" or "cancellation" of CERs mean?

CERs are recorded and tracked in electronic databases know as emissions registries. The CERs offered on this platform are recorded and tracked in the clean development mechanism (CDM) registry operated by the UN Climate Change secretariat. Voluntary cancellation, also referred to as cancellation, is the process in the CDM registry by which CERs are taken out of circulation, preventing any further use. It is similar to destroying them or marking them so they can no longer be used.[5]

Certified emission reductions or CERs are electronic certificates issued for greenhouse gas emission reductions from clean development mechanism (CDM) project activities or programmes of activities (PoAs) in accordance with the CDM rules and requirements. Each CER is equivalent to one metric tonne of carbon dioxide (CO2e) avoided or removed from the atmosphere.[5]

The situation as it stands is that since trade of these certificates is done over the internet, it does not provide appropriate supporting documents to shipping bill like courier slip, bill of lading or an Airway bill but the export of CERs is considered as export of goods (as per aforesaid discussed judicial precedence), thus there is a procedural disconnect when we analyse the export of CERs while processing refund application under GST.

Author suggests that the government may amend sub-rule (2) of Rule 89 of CGST Rules, 2017 suitably like it is recently done for export of electricity through Notification No. 14/2022-CT, dated 5-7-2022 and provide alternate supporting document to substantiate the refund claim while filing refund application.

Notes –

1. https://unfccc.int/news/cop26-reaches-consensus-on-key-actions-to-address-climate-change
2. https://unfccc.int/kyoto_protocol
3. https://cdm.unfccc.int/about/index.html
4. https://www.business-standard.com/article/economy-policy/12-gst-on-recs-renewable-power-companies-move-delhi-high-court-119041700080_1.html
5. https://offset.climateneutralnow.org/faq

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Every time.

One centralised platform for all of your digital confirmations

Bank Confirmation

Debtor/ Creditor Confirmation

Legal Confirmation

- SAS 505: External Confirmation compliant
- ISO 27001 and SOC 2 Type 2 certified
- Globally accepted platform
- 25 Indian Banks live on the network including large corporate banks **ICICI Bank, Kotak Bank, Bank of Baroda, Citibank, HSBC and Standard Chartered**
- Receive confirmation directly from the Bank

16k+
Audit firms (including the Big 4)

200k
Auditors

4k+
Responding banks and departments

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Valuation Implications of Control

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During the current start-up landscape of India, valuation has obtained a significant stronghold than it had in the past. Valuation is an intricate exercise, often involving the consideration of multiple factors to arrive at a fair value of a particular asset. One of the factors to consider during the valuation exercise is the impact of controlling interest the acquirer is positioned to gain if any during the acquisition. The article aims to demystify the key mechanics of control and its nuances on the valuation of equity.

Historical attempts at "Control"

During the days of the "British Raj", The British Colonial Government was plagued by the venomous cobras terrorizing the inhabitants of Delhi. In an attempt to control the vile creatures, the government put up a bounty on cobras, wherein for every dead cobra the people brought, they would be rewarded by the administration officials. Consequently, over time, the population of cobras in the city started diminishing & the scheme appeared successful.

However, little to the knowledge of the British, the opportunist people of Delhi started breeding cobras, which resulted in the population of cobras becoming higher than it was before the initiation of the scheme. Soon the Raj realised that they had backfired and scrapped the whole idea. The cobra breeders set the snakes free, further contributing to the original problem at hand. This came to be known as the "Cobra Effect", wherein the solution to the problem made the situation worse.

While attempting to control is difficult, valuing it is significantly challenging.

What is Control?

Control concerning any company or firm means the real decision-making power available to any party. In layman's terms, it means voting power available to move resolutions or decisions. Control can be exercised directly or indirectly through cross-holding or pyramid structures. Control has always been apex in determining value and acquisitions. It is not unnatural for acquirers to often pay a premium for substantial control.

During the present start-up ecosystem in India, control is paramount. With multiple founders, investors and other stakeholders all steering in multiple directions and moulding their start-up along the way, controlling power is all the more coveted.

Control includes the ability to choose management, its compensation, acquisition and liquidation policy, recapitalization of the company and registration of the company's stock for an initial public offering.

For the sake of simplicity, let's consider the valuation of equity shares of an investor holding only 10 shares out of 100 equity shares in a company, i.e. 10% of the total equity capital and each share carries only a single vote. Since the investor is holding only 10% equity, he can't propose and pass a special resolution on his motion. Therefore, the shares are not entitling him to any controlling power in the company. He has a vote, but not a powerful one to move the entire resolution on his own.

Accordingly, it is not wise to value shares held by this investor with the shares held by promoters holding 51% of the equity capital or more. The amount by which the valuation of these shares differs is the control discount for the investor. Viewing the same from the opposite angle, the price differential for acquiring majority shares is known as the control premium.

Valuation Nuances

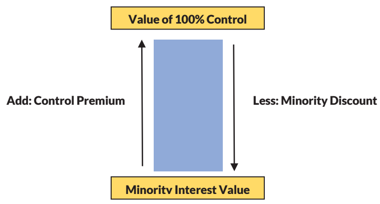
Valuation, not only controls valuation itself, but involves consideration of many inputs and judgement which can lead to a whole spectrum of valuation for a specific financial asset. Control's valuation depends on many factors including-

1. Quality of management(i. ePoorly managed vs. well-managed company).
2. Industry and maturity stage of the business.
3. Number of voting shares about total shares.

To value control, the first input is to arrive at the fair value of the financial asset using any of the suitable approaches. After arriving at the equity value, a control discount/premium is applied.

Further, as per judgements passed in the United States' court, "The minority discount is recognized because the holder of a minority interest lacks control over corporate policy, cannot direct the payment of dividends, and cannot compel a liquidation of corporate assets."

Valuation of Control Discount/Premium



Although there are only a few approaches to value control, the simplest method is to arrive at a specific percentage to account for a discount for lack of control.

The comparable method helps in arriving at a control premium by comparing the excess price paid concerning the market capitalization of the company. The excess percentage over and above the market capitalization is the control premium.

The formula for conversion of control premium to minority discount/discount for lack of control is as follows-

Minority Control = 1 – 1/[1+Control Premium]

It is suggested to incorporate multiple companies in a particular industry if available to ensure that a wide range of values and discounts are considered to ensure that the discount rate applied is representative of a wider population of data.

Empirical evidence of discount for lack of control

Per cent Mean and Median Premium Paid and Implied Minority Discount

Year of Buyout	Mean Premium Paid (%) [Without Negatives]	Implied Minority Discount (%)	Median Premium Paid (%) [Without Negatives]	Implied Minority Discount (%)	Mean Premium Paid (%) [With Negatives]	Implied Minority Discount (%)	Median Premium Paid (%) [With Negatives]	Implied Minority Discount (%)
1998	35.9	26.4	29.3	22.7	23.6	19.1	22.7	18.5
1999	46.5	31.7	32.4	24.5	40.0	28.6	28.7	22.3
2000	48.7	32.8	37.1	27.1	35.3	26.1	28.9	22.4
2001	52.1	34.3	35.9	26.4	34.0	25.4	25.9	20.6
2002	49.1	32.9	34.0	25.4	33.1	24.9	24.6	19.7
2003	53.9	35.0	37.7	27,4	46.2	31.6	33.3	25.0
2004	36.4	26.7	26.2	20.8	28.6	22.2	22.5	18.4
2005	33.1	24.9	24.3	19.5	23.1	18.8	16.7	14.3
2006	29.0	22.5	20.5	17.0	23.5	19.0	17.2	14.7

A. *Highest Mean Premium Paid [Without Negatives]: 53.9%*

Implied Minority Discount for A: 35.0% = [1/(1+53.9%)]

B. *Lowest Mean Premium Paid [Without Negatives]: 29.0%*

Implied Minority Discount for B: 22.5% = [1/(1+29.0%)]

Accordingly, the range of control premium is estimated at ~29.0%-53.9%, and the range of implied minority discount arrives at ~22.5% to 35.0%. Control premium as computed above is also known as acquisition premium. Acquisition premium is a combination of control premium and synergies. It is appropriate to account for synergies to ensure that the whole acquisition premium is misapplied as a control premium.

Empirical discounts and premiums can serve as a necessary yardstick for the valuation. For the valuations to be done for Indian companies, comparable companies' data must be relevant. It is recommended to use publically available market information of companies engaged in the same industry as that of the company being valued.

> **During the present start-up ecosystem in India, control is paramount. With multiple founders, investors and other stakeholders all steering in multiple directions and moulding their start-up along the way, controlling power is all the more coveted.**

Application of Control Premium and Minority Discount

1. **Cost Approach-Net Asset Value**

The cost approach is used for the valuation of investment and real estate companies/ REITs and other asset-heavy industries. If listed comparable companies are used to arrive at a fair value of controlling interest, the control premium is required to be adjusted since the comparable companies listed in the market are being traded at minority pricing and are indicative of minority discounts.

> **The cost approach is used for the valuation of investment and real estate companies/REITs and other asset-heavy industries.**

2. **Income Approach**

Valuation of non-controlling or controlling interests can be arrived at by considering cash flows that the business is expected to generate under each of the cases. Valuation is done based on Discounted Cash Flow method. There is no need to account for minority discount/control premium since the cash flows are already adjusted and need no further adjustment.

In case cash flows are not adjusted for controlling interests, then the valuation exercise is to be conducted based on cash flows on a 100% controlling level. Accordingly, a lack of control discount is applied on a pro-rata basis from the enterprise value.

3. **Market Approach**

In the case of the Market Approach/ Comparable Companies Method, the valuation must be undertaken based on the appropriate comparable and proper adjustment has to be made. The subject company's ownership interest must be compared with the comparable company's controlling/ non-controlling interests.

For Example: In case of valuation has to be done for acquiring a 100% subsidiary and the comparable is listed as having minority public ownership, a control premium must be applied to the fair value computed from the market approach to ensure that the ownership interests are aligned. This must be applied on an individual basis to all the comparable companies in the dataset. **Further, the Market approach entails consideration of risk and marketability discount as appropriate in every comparable used.**

The fair market values of non-controlling ownership interests in closely held companies typically cluster between 35 per cent to 50 per cent less than prices of comparative non-controlling equity interests in liquid, publicly traded companies, all other things being equal.[6]

Litigation Cases involving Control Discount

I. **Rapid-American Corp. v. Harris**

In the case of Rapid-American Corp. v. Harris 603 A.2d 796 (Del. 1992), in the United States State Supreme Court of Delaware, the court held that control premium is to be applied wherein the subject company was a controlled subsidiary.

> **Valuation is done based on Discounted Cash Flow method. There is no need to account for minority discount/control premium since the cash flows are already adjusted and need no further adjustment.**

II. **Lane v. Cancer Treatment Centres of America Inc. and Montgomery Cellular Holdings Co. Inc. v. Dobler**

Control Premium is not to be applied in case valuation is arrived at expressly using the DCF method.

III. **Bomarko Inc. v. International Telecharge, Inc.**

Control Premium is not to be applied in case valuation is arrived at expressly using the DCF method. The Court of Chancery affirmed the application of control premium in the case where the guideline public company method is followed. The court acknowledged that the market approach produced a minority value.

IV. **Cases involving rejection of discounts by state courts**

1. U. S. Inspect, Inc. v. McGreevy, 57 Va. Cir. (2000)
2. First Western Bank of Wall v. Kenneth Olsen, et al., 2001 SD 16 (2001)
3. Cavalier Oil Corp v. Harnett, Civ. A Nos 7959-60 7967-68, 1988 WL 15816 at *8 (Dl. Ch. Feb. 22, 1988)
4. Blitch v. People's Bank, 264 Ga. App. 453, 540 S.E. 2d 667 (2000)
5. Katherine B. Arnaud, et al. v. Stockgrowers State Bank of Ashland Kansas and Stockgrowers Banc Corp., 992 P.2d 216 (Kan. 1999)

Conclusion

A careful examination of the key mechanics of the transaction and deep-dive into the control aspects of the transaction is necessary for the Valuer to arrive at appropriate methods for ascertaining its impact in the valuation exercise. Therefore, control premium as well as minority discount form an integral part of the valuation exercise and should not be overlooked.

It should also not be the case that the application of incorrect values or aspirational premiums is added to the fair value that ends in crippling the valuation exercise and leaves it worse than the non-application of the aforesaid discount/ premiums, thereon giving precedence to the cobra effect.

If all aspects of the transaction are kept in mind while constructing a valuation model and choosing the appropriate valuation approach, valuations with strong reasoning and mental models are to be expected.

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Understanding the Company beyond Balance Sheet

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Information on the state of the economy, the industry outlook, competitiveness, market forces, technological change, the quality of management and human resources are not directly reflected in a company's financial statements. Many qualitative and quantitative factors that influence a company may not be obvious from its financial statements, which only shows how the company performed in the past. Many factors must be reviewed to gain a comprehensive understanding of the strength of a company. Therefore, it is necessary to look beyond the financial figures to value the company. This article is an attempt to look those factors, internal and external, which may be necessary to understand the intrinsic value of the company.

Introduction

Every company at its Annual General Meeting furnishes audited financial statements of the company showing its financial performance and financial position. These financial statements include the balance sheet, profit and loss accounts, cash flow statement and notes to accounts.

i) The Balance Sheet reflects the historical value of assets, liability and net worth of the company at particular point of time.

ii) The Profitability Statements reveals the revenue and the details of the various expenses and the net surplus/loss .

iii) The Cash Flow Statement shows the cash, which is generated from the operating activities, investment activities and from financing activities under various heads.

iv) Notes to the accounts which forms part of the Balance Sheet and Profit &Loss Accounts reveal the accounting policies, accounting standards and accounting practices adopted by the company.

Assessing the quality of a company's strength and performance is a complex process. It requires looking beyond the financial statements and further analysis of various qualitative and quantitative information to understand the company.

Information on the state of the economy, the industry outlook, competitiveness, market forces, technological change, quality of management and human resources are not directly reflected in a company's financial statements.

Board Report, Management Discussion Analysis and Corporate Governance Report does disclose certain information on business outlook, internal control systems, business opportunities, threats, risk management policy, research and development, management structure and shareholding pattern are useful in understanding the company beyond the financial figures. However, there are many more factors which needs to be considered to understand the intrinsic value of the company from the perspective of future sustainability and growth.

Understanding the intrinsic value of the company shall be of utmost important for the investors, mutual funds, private equity, venture capital, merchant bankers and high net worth individuals who take long term investment decisions. Here, intrinsic value means that ability of the company to remain viable, earn profits and continue to achieve growth in the future. Normally, the company is never valued based on the assets it holds but valued on the basis of its prospects for economic growth, future earning, competitiveness , technological upgradation and capacity to meet market threat. However the companies engaged in the reality sector and rental business, may be valued on the assets it holds.

Many qualitative and quantitative factors that influence a company may not be obvious from its financial statements, which only shows how the company performed in the past. Further, the biggest drawback of today's financial statement is that it lacks quantitative information. Earlier, the financial statements use to disclose many quantitative information on installed capacity, actual production and sales and raw material consumption to understand the performance well. However, over a period of time, these disclosures were discontinued from the financial statements in the name of business confidentiality.

> **"Assessing the quality of a company's strength and performance is a complex process. It requires looking beyond the financial statements and further analysis of various qualitative and quantitative information to understand the company."**

Many factors must be reviewed to gain a comprehensive understanding of the strength of a company. Therefore, it is necessary to look beyond the financial figures to value the company. There is no single yardstick to understand the company beyond its financial statements. There are many factors which are important to achieve this objective and it may be classified in two parts:

A. Internal Factors

B. External Factors

A. Internal Factors

1. **Installed Capacity and Utilisation**

   The installed capacity and understanding at what capacity utilisation the company functioning is important to understand the growth prospect. No company would like to keep its production capacity idle if it has good business operations. It is always considered good to work with full capacity. However, the company which is utilising its full capacity, offer little or no scope for growth at its present capacity. Any spurt in the demand of the products, the company which is utilising its full capacity will not be able to participate in additional business, where the company which is having surplus capacity , will benefit from the spurt in demand. Projects like cement, steel, textile, speciality chemicals etc. require large investments and time to create additional capacity. Therefore, companies having surplus capacity get immediate benefits in the boom period.

2. **Human/Industrial Relation**

   Human capital is now one of the most invisible assets of any company and difficult to be assessed. It is very difficult to understand human behaviour and their competency. However, studies on employee training, reward and recognition policy, performance appraisal methodology, employee turnover and attrition rate, Stock Option Scheme, etc. may be helpful to understand the HR Policy of the company. These are very important for the valuation of the companies engaged specially in IT Sector as they are assessed and valued based on employee strength and their quality. Markets do take cognizance of the HR policies for the companies like Infosys, Wipro, TCS etc.

   Similarly industrial relations are also the judge on the history of the lock outs, strikes and labour unrest occurred in the company during past periods.

3. **Reading notes to accounts**

   The Notes to accounts forms part of the balance sheet and profit and loss accounts. Apart from the statutory disclosure as required under the schedule II of the Companies Act 2013, the Notes to accounts makes many disclaimers and disclosures, which may be necessary to understand the company performance and position. The size of these notes to accounts are many times larger than the size of the financial statements and thus there is a possibility that the important disclosures or contingent liabilities affecting the company may remain unnoticed.

   Pending court cases and litigations, huge demands from revenue authority, any legal proceeding taken under the Insolvency and Bankruptcy Code, etc, as disclosed in the note to the accounts, may affect the working or survival of many companies as going concern.

   Further, there are various off-balance-sheet financing options which include special-purpose entities, leasing transactions, debt guarantees, co-borrowing arrangements, securitisations, and other contingent obligations that may not require recognition on the balance sheet. An analysis of these off-balance sheet items is necessary to understand its effect on the company's ability to continue.

4. **Chairman Statement**

   Though it is not mandatory, Chairmen of many companies share the vision of the company in their statement to investors. This statement is sometimes given along with the annual report or it may be published in prominent newspapers. This is a forward-looking statement on the current performance of the company and its future business outlook and strategy as well. This is widely read by the well-informed investors.

5. **Segment-wise performance/ Product diversification**

If the company is operating in more than one segment, segment wise reporting is provided in the annual report. This will facilitate to understand the contribution of each segment in the revenue and growth of the company and help the investor make a better analysis of the risk and returns of the organisation.

Many companies also adopt the route of the subsidiary company for the different and diversified activities/ products and many times it is also noticed that companies go for demerger for different segments for better management. As per the market report, Mahindra & Mahindra is initiating a restructuring plan to trifurcate its flagship automobiles business into electric vehicle, tractor and passenger vehicle business into three independent companies via a demerger process.

> **Solar power is much cheaper now and many companies are installing solar power and opting net metering arrangement to reduce the power cost.**

The evaluation of the performance of these subsidiaries are equally important to understand the performance of the holding company.

6. **Events occurred after Balance Sheet date**

The economic and political situations keep changing at national and international levels and it may have a favourable or adverse effect. The situation may be:

1. Government of any country may put restrictions on exports/ imports.
2. Imposition of anti-dumping duty by the importing country.
3. Banning of use of any products, like ban on use of certain plastic products in India.
4. Any major break down due to nature calamity, fire or labour unrest.
5. Any major legal actions or proceeding against the company.
6. Occurrence of pandemics like COVID.

A prudent investor should always keep an eye on such events which may affect the business of the company.

7. **Captive Power Plant**

Power is an important input for many industries and forms the major cost of production, especially in aluminium and steel industries, power cost is substantial. It is observed that if the power is produced in house for captive consumption, it is much cheaper than the purchasing the power from outside. Further, captive power plant reduces the dependency on the outside supply and ensures uninterrupted power supply. Solar power is much cheaper now and many companies are installing solar power and opting net metering arrangement to reduce the power cost. Also they are selling surplus power to stakeholders outside. Almost all the business houses like Tata Steel, Hindalco, M&M, Reliance, etc have power plants for captive consumption and also installing green energy plants to save power cost and reduce the load on the environment as well.

8. **Family /Professional Management/Governance**

In India, family managed companies play a vital role and influences the vision and mission of the company. Some groups control the management through the holding company and give the subsidiary sufficient autonomy for day-to-day functioning. In case of family managed company, people look at the succession management planning for sustainability.

There are professionally managed companies also which are very successful without being associated to any business family, like Larsen & Toubro (L&T).

For listed companies, the appointment of independent directors are mandatory and the composition of Board of these companies also affect the market perception. Hence corporate governance is becoming prominent in the corporate world.

9. **Collaborations**

The nature and type of collaborations, the company have entered also decide their superiority in terms of technology, finance, marketing, etc. Looking at these collaborations shall help in understanding the strength of the company. For example the Japanese subsidiary of Mahindra & Mahindra, Mitsubishi Mahindra Agricultural Machinery Co., Japan and Kubota Co., Japan have entered into a business collaboration arrangement for the Japanese market. Similarly, severance of the collaboration agreement may happen affecting the business as occurred in the case of Hero group and Honda group.

10. **Out-Licensing**

Out-licensing is a relatively new phenomenon in the Indian market. Due to lack of required in-house facilities to develop patented products, companies are adopting out-licensing strategy for production. As it becomes more expensive to develop new products, out-licensing collaborations are fast becoming a favoured option specially for pharmaceutical companies to save on research and development investments.

11. **Research & Development**

Research and development is a continuous process which keeps the company ahead of competitors in terms of technology and innovation. Through R & D, the company may

1. develop new products,
2. modify/change product design,
3. design new process to improve quality ,
4. reduce operating cost by substituting the cheaper raw material,
5. reduce production cycle time,
6. develop/ explore new markets etc.

The company which has in house R & D facility finds preference, since it ensures confidentiality and continuity.

12. **Incentives**

Government of India (GOI) and many state governments offer various incentives for the development of certain sectors and undeveloped areas. These incentives play a very vital role for the growth and economic viability of the company. Central Government offers incentives for agro- processing sector, horticulture sector, development of North-Eastern region, etc, Similarly, state governments offer incentives to MSME, large, and mega units to attract investments in their states. Availability of such incentives shall be studied to understand the benefits to the company.

> **"The nature and type of collaborations, the company have entered also decide their superiority in terms of technology, finance, marketing, etc. Looking at these collaborations shall help in understanding the strength of the company."**

Recently, GOI has declared Production Linked Incentive Scheme (PLI Scheme) to encourage local production and to create employment. The Central government's flagship PLI scheme, was announced in March 2020, is operational for 15 sectors such as electronics and mobile manufacturing, solar equipment, pharmaceuticals, medical devices, automobiles and auto components, among others. These schemes increase the profitability of the eligible companies.

13. **Merger /Amalgamation/ Acquisition**

The value of the company changes with the change in the management. These changes may have occurred due to merger, amalgamation or acquisition Such developments should also be kept in mind. It helps companies gain access to a larger market and customer base, reduce competition, and achieve economies of scale in a shorter time.

For example, L&T has acquired Mindtree, Patanjali Ayurveda Ltd. acquired Ruchi Soya, Godrej Agrovet, acquired stakes in Astec Life Science Ltd., Tata Steel acquired Bhushan Steel, etc leading to more value creation in the market through these mergers, amalgamations and acquisitions.

14. **Shareholding Pattern and Pledging of Promoters' holding**

The shareholding patterns and any change therein is also given in the annual report under Corporate Governance Report. This should also be studied to know the promoters holding in the company and any change that took place during the year. The higher the promoters holding, the larger is their commitment in the company and viewed as positive.

> **The value of the company changes with the change in the management. These changes may have occurred due to merger, amalgamation or acquisition Such developments should also be kept in mind.**

It is also observed that some of the promoters keep their holding in the company as pledge with financial institution or banks as security for taking loans or for some obligations. This aspect is also requires observation . If due to default, the pledged shares are sold in the open market, it may affect the existing management. For example in Eveready Industries India Ltd., lenders had to sell pledged shares due to promoter group default on repayment.

15. **Replacement cost**

    The present cost of replacement of setting up of the similar units is sometimes considered by the market forces. However, with the technological development and innovation, replacement cost theory is losing its relevance as new technology has reduced the operating cost substantially with improvement in quality and functional utility.

B. External Factors

1. **Brand value**

   Branding is important when trying to generate future business. A strongly established brand increases the business value by giving the company more leverage in the industry. Many times brands enjoy more independent value than the name of the company manufacturing the branded products. In the apparel market, brands like Van Heusen, Louis Phillipe, Allen Solly, Peter England, Pantaloons are owned by Aditya Birla Fashions Ltd. Arrow is owned by Arvind Fashions Ltd. Park Avenue, ColorPlus, Parx, are owned by Raymond Ltd. These brands are recognised by the public by their brand name rather than the name of the company owning the brands. Also, manufacturers push the brand name rather their company name. These brands are independently sold in the market at premium and the acquirers capture the market immediately.

2. **External Credit Rating**

   The credit rating assigned by the external rating agencies like CRISIL,CARE, ICRA, FITCH, etc. is important to understand safety of the investment. They evaluate the project according to their strength and do SWOT analysis and assign the rating according to risk perception. The higher the rating, the safer is the investment and such companies can obtain loans at lower interest rates. Especially regarding the debt instruments, rating plays a vital role for the investors' safety. The ratings are assigned for long term loans and short term loan facilities separately.

The rating assigned signify as under:

Long term Rating		Short term Rating	
Rating (Long term)	**Degree of safety/ default on Long term Scale**	**Rating (Short term)**	**Degree of safety/ default on Short term scale**
AAA	Highest safety	A 1	Very strong
AA	High safety	A 2	Strong
A	Adequate safety	A 3	Moderate
BBB	Moderate safety	A 4	Minimal
BB	Moderate risk of default	D	Defaulter or expected to be defaulter
B	High risk of default		
C	Very high risk of default		
D	Defaulter or expected to be defaulter		

3. **Risk analysis**

Understanding the nature of a company's business and the inherent risks is important when analysing financial position. The nature of a company's business depends on many factors, including the size of the company, where the company is in its life cycle, the geographic areas it operates in, and the competitive landscape in which it operates. Risks are inherent in the business. The risk may be market risk, credit risk, environment risk, Forex risk, etc. Management Discussion Analysis make a special mention about risk management policy and should be read carefully. Few examples are:

- A highly leveraged company may be exposed to a great credit risk in terms of timely repayment obligation. The enactment of Insolvency and Bankruptcy Code and the right conferred to the secured and unsecured, has made the situation more vulnerable which are not meeting their financial obligations in time. There are many companies which change hands in management and NCLT has ordered for liquidation.
- Companies operating international trade are subject to country risk. The recent war between the Russia and Ukraine and the involvement of many other countries in the war has affected the international trade and both importing and exporting countries are facing lot of problems. The automobile sector is facing a dramatic shortage of microchips and components globally.
- External commercial borrowings in foreign currency may subject to currency fluctuation risk, if not hedged. The impact may be positive or negative.
- Market risk may cover the client concentration, distribution channel and policy, product life cycle, change in customers choice, development of substitutes with improved features. etc. The companies engaged in consumer products are more prone to market risk due to change in customer behaviour.
- The Government has begun stipulating stringent norms and regulations to control environmental regulations and many times it is observed that working of the companies are suspended due to non-compliances of these norms. Many mining companies are also facing the same environmental problems in their operation or renewal of lease from the Goverment.

The various risk factors should be analysed properly for long term sustainability of the company.

> **"The nature of a company's business depends on many factors, including the size of the company, where the company is in its life cycle, the geographic areas it operates in, and the competitive landscape in which it operates."**

4. **Control over the Raw Materials**

Uninterrupted availability of raw material is vital for the running of units of the company. Companies having in-house supply of raw materials will be more valuable than the company sourcing from outside. For example, there are many steel making companies like JSW, Tata Steel, etc which have their own mines for the supply of raw materials like iron ore, manganese, coal etc. Such companies which have captive arrangement for supply of raw materials are less dependent on the market for the supply and they command the premium in the market.

5. **Patent/ Licence / Entry Barrier**

The points to be considered are:

1. The companies that have patented their products or process, restrict the entry of others till the validity of patent period. The unexpired period of the patent is important to understand its long-term impact.
2. There are sectors like banking, telecom, Airlines etc which require licence to operate. It is a time-consuming process to get the new licence. Therefore acquisition routs are adopted to enter into these fields. Recently Tata has acquired Air India from the GOI.
3. Pharmaceutical companies require approval from the FDA, in India or abroad, before launching the product for commercial application.

4. The requirement of large investment and innovation creates entry barrier for new-comers. Projects like refinery, semiconductors, integrated steel plant, etc. fall under this category.

The investors should take cognisance of the companies having the above advantage.

6. **Product approvals**

There are products which require prior approval from the competent authority before its commercial production. The process may take a long time to get the required approvals. For example, for making supply for defence use, products are to go through the stringent safety and quality norms of the Defence Procurement Policy of Ministry of Defence, Government of India.

Similarly in the pharma sector, approval process takes a long time and on approval, market capitalisation increases.

7. **Conclusion**

From the above it is evident that quality of the financial position and strength of any company are to be viewed from various internal and external parameters. One has to move and look beyond the balance sheet. The evaluation and analysis of the performance are carried out taking into consideration the above points which is an illustrative way to understand and evaluate the company. Each criteria has its own comparative advantage and limitation. Depending upon the object of the study,

> **Quality of the financial position and strength of any company are to be viewed from various internal and external parameters. One has to move and look beyond the balance sheet.**

these parameters can be used obtain a clearer understanding of the financial position and strength of any company.

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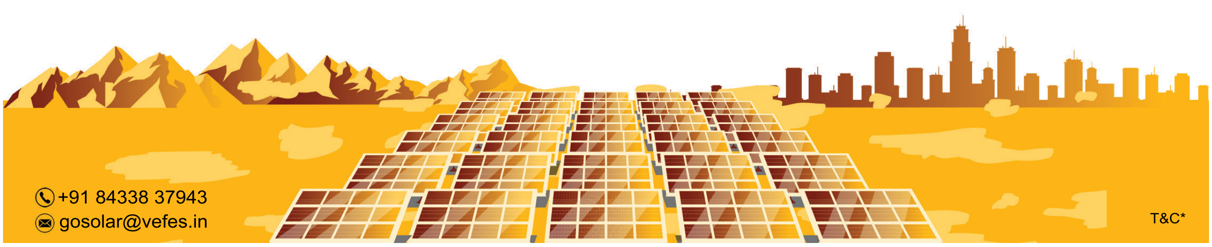


Non-compliances observed in the Ind AS Financial Statements pertaining to Other Disclosure

Financial Statements are the paramount source in hands of the stakeholders to understand the financial well-being of an enterprise. The users are highly reliant on the information presented in the financial statements and therefore the preparers ought to ensure that it is correct, complete, relevant and adhere to the applicable regulatory requirements. Financial Reporting Review Board (FRRB) reviews the General Purpose Financial Statements (GPFS) of enterprises with the view to identify the non-compliances with Accounting Standards/ Ind AS and Standards of Auditing, CARO, Companies Act, and other applicable statutory requirements.

Contributed by the Financial Reporting Review Board of the ICAI. Comments may be sent to frrb@icai.in and eboard@icai.in

The non-compliances observed by the Board are compiled and published under the name of ''Study on Compliance with Financial Reporting Requirement''. Till date three volumes of the aforesaid publication have been released by the Board. Further, one more publication on "Study on Compliance of Financial Reporting Requirements (Ind AS Framework)" has been released for preparers and auditors of the Ind AS financial statements. In addition, the Board publishes such non compliances observed by way of articles in the 'Journal' of the Institute. This article is in furtherance of the FRRB's endeavour to update the members and other stakeholders in the field of financial reporting.

It may be noted that in the article, the observations related to Ind AS framework have been classified on the basis of components of financial statements i.e. Assets, Equity, Liabilities for Balance Sheet and revenue, interest income, employee benefits etc. for Statement of Profit and Loss and likewise. This article deals with the non-compliances, observed by the Board, with regard to Other Disclosures which is an important element for Ind AS financial statements.

Observations related to Other Disclosures

Non-disclosure of Accounting Policy

Case:

A company has given a note regarding mining operation which read as follows:

"The company's mining operations at the lease mine remained suspended during the year owing to the ban imposed by the regulatory authority. The company's investments in the said cash generating unit consists of Trucks, Trippers, material handling equipment, and similar movable assets and also a long-term lease premium was paid in respect of the said land and the mine development expenses were incurred by the company. These assets continue to be carried at cost less accumulated depreciation and amortization, and depreciation/ amortization expense for the current year has been charged to the Statement of Profit and Loss. The said treatment is owing to the management expectation of re-starting with the mining activity and the fact that the transportation vehicles are otherwise being used for other business purposes of the company".

Principle: Ind AS 1, Presentation of Financial Statements

Paragraph 117– Disclosure of accounting policies

"An entity shall disclose its significant accounting policies comprising:

(a) the measurement basis (or bases) used in preparing the financial statements, and

(b) the other accounting policies used that are relevant to an understanding of the financial statements."

Observation:

It was noted from the financial statements of the company that the accounting policies of impairment of assets and segment reporting, being significant accounting policies, have not been disclosed.

It was noted from note to the financial statements regarding mining disclosures that the company's mining operation was suspended. It was viewed that the management was required to make judgement whether it is discontinued operation of major component of an entity as per Ind AS 105 or there is indication about the impairment of assets as per Ind AS 38. Accordingly, it was viewed that the accounting policy of the same should have been disclosed. With regard to segment reporting, it was noted that the company is in diversified business. Accordingly, the accounting policy for the same is also significant.

Both accounting policies have been considered as significant accounting policies which are relevant to the understanding of the financial statements and hence, should have been disclosed as per the above stated requirements of Ind AS 1.

Accordingly, it was viewed that the requirements of Ind AS 1 have not been complied with.

Related Party Disclosure

Case:

In the note to the financial statements of a company on Exceptional Items, the exceptional items included waiver of interest receivables from a related party. No disclosure in this regard was given under related party disclosures.

Further, the items reported under exceptional items included expense on account of waiver of regulatory accrual, however, the nature of such expense was not clear.

Principle: Ind AS 24, Related Party Disclosures

Paragraph 18– Disclosures

"If an entity has had related party transactions during the periods covered by the financial statements, it shall disclose the nature of the related party relationship as well as information about those transactions and outstanding balances, including commitments, necessary for users to understand the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to those in paragraph 17. At a minimum, disclosures shall include:

a) the amount of the transactions;

b) the amount of outstanding balances, including commitments, and:

   i. their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

   ii. details of any guarantees given or received;

c) provisions for doubtful debts related to the amount of outstanding balances; and

d) the expense recognised during the period in respect of bad or doubtful debts due from related parties."

Observation:

It was viewed that expense on account of waiver of an interest receivable is a bad debt. **As the expense pertains to a related party, it requires disclosure under Related Party Disclosure as per paragraph 18 (d) of Ind AS 24. However, under related party disclosure, no disclosure was given in this regard.**

Further, an item can be classified as an exceptional item only if the criteria mentioned in paragraphs 97 and 98 of Ind AS 1 has been met.

Accordingly, it was viewed that the requirements of Ind AS 24 have not been complied with.

Financial Risk Management

Case:

In the note to the financial statements on Financial Risk Management, the disclosure with regard to credit risk, liquidity risk and market risk were made. However, disclosure for liquidity risk is not complete.

Further, the total of financial liabilities (except Financial Guarantee {Contingent Liability}) given under this note did not match with the total of the financial liabilities as per the Balance sheet.

Principle:- Ind AS 107, Financial Instruments: Disclosures

Paragraph B11E – Quantitative liquidity risk disclosures

"Paragraph 39(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative disclosures required in paragraph 39(a) and (b). **An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk** (eg financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk."

Observation:

The following discrepancies were noted with regard to disclosure of financial risk and financial liabilities:

a) It was noted that the disclosure with regard to credit risk, liquidity risk and market risk were made. However, while giving "exposure to liquidity risk", **maturity analysis of financial assets held by company for managing liquidity risk, was not disclosed**. It is, therefore, not in line with the requirement of paragraph B 11 E of Ind AS 107.

b) It was further noted that under note to the financial statements on Financial Risk Management, the company's financial liabilities at the reporting date were disclosed and classified on the basis of remaining contractual maturities of financial liabilities. However, the total of financial liabilities (except Financial Guarantee {Contingent Liability}) given under this note did not match with the total of the financial liabilities as per the Balance sheet for all the three years presented in the financial statements. Such difference in amount reported raised doubt regarding the correctness of the information given in the financial statements.

Accordingly, it was viewed that the requirements of Ind AS 107 have not been complied with.

Segment Reporting

Case:

Abstract of note to the financial statements on Segment Reporting read as follows:

"Segment Information

The Company is engaged in the business of Branding, Manufacturing, Processing, Selling and Distribution of "Consumer Products" which constitutes a single reporting segment. Hence there is no separate reportable segment under Indian Accounting Standard on Ind AS 108 'Operating Segment'.

Geographic Information

There are no revenues or non-current operating assets from external customers outside India."

Principle:-Ind AS 108, Operating Segments

Paragraph 32 of Ind AS 108 – Information about products and services

"An entity shall report the revenues from external customers for each product and service, or each group of similar products and services, unless the necessary information is not available and the cost to develop it would be excessive, in which case that fact shall be disclosed. The amounts of revenues reported shall be based on the financial information used to produce the entity's financial statements."

Observation:

It was noted that although the company is engaged in the single reporting segment but paragraph 32 of Ind AS 108 is applicable on single segment entities also, however, **the required disclosures were not given by the Company.**

Accordingly, it was viewed that the requirements of Ind AS 108 have not been complied with.

Fair Value Measurement

Case:

From the notes to the financial statements of a company on Non-current financial assets and Current financial assets, it was noted that the company has investments in mutual funds.

Principle: Ind AS 109, Financial Instruments

Paragraph 4.1.1– Classification of financial assets

"Unless paragraph 4.1.5 applies, an entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

a) the entity's business model for managing the financial assets and

b) the contractual cash flow characteristics of the financial asset."

Paragraph 4.1.2– Classification of financial assets

"A financial asset shall be measured at amortised cost if both of the following conditions are met:

a. the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and

b. the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding."

Paragraph 4.1.2A– Classification of financial assets

"A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding."

Observation:

It was viewed that as per the requirements of Ind AS 109, financial assets are initially measured at fair value. Subsequent to initial recognition, these should be measured at amortised cost, fair value through other comprehensive income (FVOCI) or Fair Value through Profit and Loss (FVTPL). Amortised cost classification is permissible for debt instruments only if they meet both business model test and the contractual cash flow characteristics test. Similarly, in Ind AS 109, there are conditions for financial assets in case if they are valued at FVOCI or FVTPL.

However, in the given case**, it was viewed that the disclosure with regard to financial assets at amortized cost, financial assets valued at Fair value through profit and loss and financial assets valued at fair value through other comprehensive income has not been provided in the financial statements. Also, the measurement whether at cost or fair value through profit and loss or fair value through other comprehensive income has not been defined.**

Accordingly, it was viewed that the requirements of

Ind AS 109 have not been complied with.

Signing of Financial Statements

Case:

An abstract of Balance Sheet, Statement Profit & Loss, Statement of Changes in Equity and Cash Flow Statement was as follows:

"For and on behalf of the Board of Directors

Sd/-

Director

DIN:"

Principle: Companies Act, 2013

134. Financial statement, Board's report, etc.

(1) The financial statement, including consolidated financial statement, if any, shall be approved by the Board of Directors before they are signed on behalf of the Board at least by the chairperson of the company where he is authorised by the Board or by two directors out of which one shall be managing director and the Chief Executive Officer, if he is a director in the company, the Chief Financial Officer and the company secretary of the company, wherever they are appointed, or in the case of a One Person Company, only by one director, for submission to the auditor for his report thereon.

...

Section 158 Obligation to indicate Director Identification Number

"Every person or company, while furnishing any return, information or particulars as are required to be furnished under this Act, shall mention the Director Identification Number in such return, information or particulars in case such return, information or particulars relate to the director or contain any reference of any director."

Observation:

It was noted from the financial statements that one of the directors of the company signed the Balance Sheet, Statement of Profit and Loss, Statement of Changes in Equity and Cash Flow Statement without incorporating his full name and DIN (Director Identification Number).

It was viewed that the director should incorporate his full name and DIN, below his signature in order to identify his authentication.

Accordingly, it was viewed that the requirements of Section 134 read with section 158 of Companies Act, 2013 have not been complied with. ■■■

Classifieds

5947 We are 11 year old Professional Practice; looking for Firms who are interested to officially merge with us. Please mail: firms@shahteelani.com

5948 Required Partners for a Partnership firm at Kottayam. Contact details Thomas K George 9447773937 email id: cathomaskgeorge@gmail.com

5949 Indian Chartered Accountant, iving in Germany having working experience in Accounts, Audit and finance Germany looking for subcontracts/partnerships in Germany/Europe in Accounts, Audit, Finance and investigations. Please contact email manimadathil@yahoo.com

5950 We are 54 years old CA firm having 17 partners & H.O. at Delhi are looking for 10 or more years old proprietor firm at Bhuwneshwar, Chennai, Guwahati, Hyderabad, Jaipur & Ranchi for merger. Interested firms can send proposal with profile on : jk.sarawgi@jksco.in, Whattsapp – 9871599182

5951 32 year old Firm Headquartered in Delhi NCR invites proposal for merger with sole proprietorship or partnership firms. Mail with brief profile to sangeeta.pgc@gmail.com or call 9811278153

5952 Raipur based old CA Firm requires CA having minimum 3-5 years experience in company Statutory & Internal Audit. Email- raipur@rdnaca.in

5953 Required Partners for a Partnership firm. Call /Chat Mail on 9920317933/ 9321787756 casgd.office@gmail.com.

ACCOUNTANT'S BROWSER

PROFESSIONAL NEWS & VIEWS PUBLISHED ELSEWHERE

Index of some useful articles taken from Periodicals received during November - December 2022 for the reference of Faculty/ Students & Members of the Institute.

1. Audit

CARO 2020 – Tighter controls over NBFCs by Bhavesh Vora. *Bombay Chartered Accountants Journal*, November 2022.

Is auditor tolerant of earnings management in socially responsible firms? Evidence from China by Huy Viet Hoang, Tung Ha, Manh Linh Tran and Thi Thu Trang Nguyen. *Asian Review of Accounting*, vol.30, No.5, 2022, pp.669-690.

2. Economics

Corporate disclosures and financial distress in banks in India: the moderating role of competition by Shailesh Rastogi and Jagjeevan Kanoujiya. *Asian Review of Accounting*, vol.30, No.5, 2022, pp.691-712.

Estimating poverty in India without expenditure data: a survey-to-survey imputation approach by David Newhouse and Pallavi Vyas. *Economic & Political Weekly*, November 2022, pp.34-43.

Health expenditures, health infrastructure and health status in SAARC Countries: a panel data analysis by Subhalaxmi Mohaptra. Vikalpa *The Journal for Decision Makers*, July - September 2022, pp.205-216.

Payment flow as economic indiators: Nowcasting using a hybrid mahine learning framework by Amit Kumar, Shivam Nigam and Sandhya Kuruganti. *RBI Bulletin*, November 2022, pp.103-114.

Start-up India scheme – start-up companies, its registration and its advantages by R Balakrishnan. *Chartered Secretary*, November 2022, pp.38-46.

3. Law

MSMES: a growth oriented analysis of the legal development, beneficial schemes and judicial approach by Mamata Biswal. *Chartered Secretary*, November 2022, pp.34-37.

4. Management

Corporate governance concerns in startups by Abhinav Kumar. *Chartered Secretary*, November 2022, pp.52-55.

Corporate social responsibility and firm market performance: the role of product market competition and firm life cycle. *Asian Review of Accounting*, vol.30, No.5, 2022, pp.713-745.

Scale purification and validation: a methodological approach to sustainable online retailing by Suhail Ahmad Bhat, Ajaz Akbar Mir and Sheikh Basharul Islam. *Vikalpa The Journal for Decision Makers*, July - September 2022, pp.217-234.

Your company needs a space strategy now: Rapidly falling launch costs and fleets of new satellites are opening up big opportunities for business by Matthew Weinzierl, Prithwiraj (Raj) Choudhury, Tarun Khanna, Alan MacCormack and Bredan Rosseau. *Harvard Business Review*, November-December 2022, 80-91.

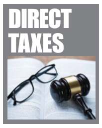
5. Taxation and Finance

New provisions for filling an updated return of income by P.N. Shah and Arti Shah. *Bombay Chartered Accountants Journal*, November 2022.

Online gaming: game is still on under GST by D.S. Mahajani. *Goods & Services Tax Cases*, November 29 - December 5, 2022, pp.31-40.

Full Texts of the above articles are available with the Central Council library, ICAI, which can be referred on all working days. For further inquiries please contact on 011-30110419 and 011-30110420 or by e-mail at library@icai.in.

Legal Decisions



Income Tax

LD/71/63 Delhi High Court: W.P No.7122/2019 Ravinder Kumar Aggarwal Vs. The Income Tax Officer, Delhi 17th November 2022

High Court dismissed petition of assessee and imposed Rs. 50000 cost, whereby the assessee had challenged notice u/s 148 issued in the name of a struck-off company, noting that the said company was restored by NCLT; By virtue of Section 252(3) of the Companies Act, 2013 as per which NCLT's order for restoration of a company will have the effect of placing the company in the same position as before striking-off and deemed to be in existence; High Court relied on Supreme Court ruling in Gopal Shri Scrips, wherein it was held that HC was wrong in dismissing the appeal filed against the struck off Company.

LD/71/64 Delhi High Court: W.P No.15387/2022 The Boeing Company Vs. Union of India & Ors 17th November 2022

High Court set aside order under Section 148A(d) and directed Revenue to pass an appropriate order dealing with all the objections raised by the Assessee to notice u/s 148A(b); Proceedings u/s 148 were initiated on the ground that receipts of assessee from providing licensed material and ancillary service were taxable in India and assessee was not entitled to the benefit of India-US DTAA as it had failed to furnish Tax Residency Certificate (TRC); Assessee's reliance on SC ruling in favor of assessee was rejected without reasons by the Revenue and also the TRC were found to be duly furnished to Revenue by the assessee.

LD/71/65 Delhi High Court: ITA 577/2018 The Prin. Commissioner of Income Tax Vs. Rishikesh Buildcon 17th November 2022

Delhi High Court upheld ITAT order deleting penalty imposed under Section 271D in violation of Section 269SS and holds that the penalty order to be barred by limitation since passed beyond the time limit of six months as provided under Section 275(1)(c); Revenue noted that assessee received Rs.5.43 Cr in cash in violation of sec. 269SS; Where the penalty proceedings are initiated with the assessment order, the date of assessment order is to be taken as the relevant date for the purpose of Section 275(1)(c); Date of the issuance of notice of penalty is not a starting point for limitation.

LD/71/66 Delhi High Court: ITA 428/2022 The Prin. Commissioner of Income Tax Vs. M/s AT and T Communication Services India P Ltd 17th November 2022

High Court deleted interest charged under Section 220(2) holding that section 220(2) does not empower the revenue to demand interest relating back to a set-aside order, when a fresh assessment order has been passed thereafter; High Court also referred to the CBDT Circular No. 334 dt. April 3, 1982, which expressly states that if the assessment order is 'set aside' by the appellate authority, no interest under Section 220(2) can be charged pursuant to the original demand notice; High Court revenue's submission that since the addition and tax liability of the assessee remained the same even after the matter was considered afresh, the assessee was liable to pay interest.

LD/71/67 ITAT Ahmedabad: ITA No.1788/ Ahd/2019 Income Tax Officer Vs. Smt. Mamta Rajivkumar Agarwal 11th November 2022

ITAT ruled in favor of assessee on deletion of addition made on account of bogus long term capital gain (LTCG) claimed under Section 10(38) merely on assumption and surmises that modus operandi pertained to a penny stock; CIT(A) had allowed assessee's appeal and held that the shares were purchased through broker on recognized stock exchange and the payment was made through banking channels which was supported by documentary evidence, and the Revenue had failed to discharge its onus by not bringing any iota of evidence to substantiate the allegations of bogus penny stock gain.

LD/71/68 ITAT Chandigarh: ITA No.454/ Chd/2022 Agya Ram Manohar Lal Vs. The Prin. Commissioner of Income Tax, Ludhiana 10th November 2022

ITAT ruled in favor of Revenue and upheld revisionary order setting aside assessment order due to failure in applying the correct rate of tax as per Section 115BBE on the addition made under Section 69C; AO had made an addition of 42 lacs u/s 69C and Rs. 12.46 lacs u/s 69; CIT(A) reduced Section 69C addition to Rs.28.37 Lac; Prin CIT

Contributed by CA. Sahil Garud, Disciplinary Directorate and ICAI's Editorial Board Secretariat. For details please visit Editorial Page webpage at https://www.icai.org/post/editorial-board. Readers are invited to send their comments on the selection of cases and their utility at eboard@icai.in. For full judgement write to eboard@icai.in.

had initiated proceedings u/s 263 on the premise that AO calculated the whole income at normal rate of 30% instead of charging special rate u/s 115BBE; ITAT held that issue does not pertain to non-applicability of Section 115BBE but pertains to applicability of rate of tax u/s 115BBE and the AO erred in not applying the rate of tax as per the amended law and the order so passed is rightly held by PCIT as erroneous.

LD/71/69 ITAT Mumbai: ITA No.510/ Chandi/2017 State Bank of India Vs. Asst. Commissioner of Income Tax 10^{th} November 2022

ITAT Special Bench held that deduction u/s 36(1)(viia) read with Rule 6ABA is to be allowed on the total outstanding advances at the end of each month considering the opening balances; Revenue had held that only incremental advances made during the month can be considered while calculating the figure of 'aggregate monthly average advances'; ITAT Special Bench observes that the identical issue has been decided in favour of the taxpayer by Calcutta HC in Uttarbanga Kshetriya.

LD/71/70 ITAT Panaji: ITA No.462/PAN/2018 Shri Anantnath Alpasankhyatar Vividh Uddeshagal Souhard Sahakari Niyamit Vs. The Income Tax Officer 09^{th} November 2022

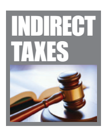
ITAT directed CIT(A) to pass a speaking order mentioning the relevant provision if any, under which the distinction between deposits/ investments held for a period of more than one year to be treated as 'Income from other sources' and for a period less than one year as 'Business income' has been drawn; CIT(A) allowed deduction under Section 80P(2) on all the interest incomes except the interest earned on long term investments/deposits made for a period more than one year; ITAT remarked that relevant distinction between the short term and long term deposits and the consequential eligibility / non-eligibility for deduction u/s 80P, is not borne out from the impugned order of CIT(A).

LD/71/71 Delhi High Court: W.P. No. 8422/2022 Rajesh Katyal Vs. Income Tax Department 03^{rd} November 2022

High Court ruled in favor of assessee on matter of non-retrospective application of the Benami Transactions (Prohibition) Amendment Act, 2016 by quashing notice issued under Section 53; It was noted that the alleged benami transactions undertaken by the Assessee were entered prior to Nov 1, 2016 i.e. before Benami Act came into force; HC noted that the one AK Infosystems Pvt. Ltd. was the owner of the land alleged to be held benami and the concerned land properties were purchased between 2007 to 2010 and that the Assessee resigned as a director of the said company in 2008 and sold his entire shareholding in the said company on May 31, 2014.

LD/71/72 ITAT Chennai: ITA No. 3334/Chny/2019 Asst. Commissioner of Income Tax Vs. Lifecell International Private Limited 02^{nd} November 2022

An appeal or claim pending before the appellate forum which was withdrawn in terms of certificate issued by VsV authority shall deemed to have be revived, the moment any of the condition stipulated in the certificate is violated; ITAT observes that although it is a legal position that any appeal pending before the appellate authorities shall be deemed to have been withdrawn from the date certificate under Section 5(1) was issued by designated authority but as per Section 4(6) the declaration under Section 5(1) shall be presumed never to have been made if any material particulars furnished in the declaration are found to be false at any stage and all the consequences under the Income Tax act shall be deemed to have been revived.



LD/71/73[2022-TIOL-1478-HC-Jharkhand-GST] [10-11-2022] M/S Usha Martin Ltd Vs. Additional Commissioner CGST & CEx and Ors

The Hon'ble Court held that as the proceedings for wrongful availment of CENVAT Credit have been initiated under Section 73 (1) of the CGST Act instead of the relevant provisions of the C.E.A. and Finance Act read with Rule 14 of the C.C.R., 2004, the same is without jurisdiction.

LD/71/74[2022-TIOL-1398-HC-MUM-ST] [3-10-2022] Sodexo India Services Pvt Ltd Vs. The Union of India and Ors

The High court set aside the orders rejecting the appeals on the ground that payment of pre-deposit through DRC-03 is not permissible for appeals arising under the Pre-GST law and directs CBIC to issue a suitable clarification.

Legal Updates

LD/71/75[2022-TIOL-1449-HC-MUM-GST [14-11-2022] M/S Sanathan Textile Pvt Ltd Vs. UoI

The court held that Notification No.79/2017 dtd.13-10-2017 extending the exemption of IGST and Compensation Cess to import of capital goods under the valid authorisation under the EPCG Scheme is retrospective in nature and hence, the exemption was also available during the period 01-07-2017 to 12-10-2017.

LD/71/76[2022-TIOL-1496-HC-AHM-ST [12-10-2022] Modern Petrofils Vs. Commissioner of Central Excise and Service Tax Vadodara-II

The Court held that the technicalities should not come in way in permitting the party to agitate the case on merits before the court of law and directed that appeal dismissed for delay in removing the objections raised by the office of the appellate authority, was directed to be restored on removing such deficiencies.

LD/71/77[2022-TIOL-1132-CESTAT-AHM [28-11-2022] Safal Construction Pvt Ltd Vs. Commissioner of Central Excise and Service Tax

When all the parties to the co-development agreement have been assigned their respective jobs and all have performed them in favour of the joint venture in which again all the three parties are participants, it cannot be said that one of the participants while performing its job has provided any service to the joint venture.

LD/71/78[2022-TIOL-1062-CESTAT-KOL [17-11-2022] M/S ITC Sonar Vs. Commissioner of CGST and Central Excise

The third proviso to Rule 4(1) of the CENVAT Credit Rules, 2004 inserted w.e.f. 1-09-2014 which introduced a time limit for the purpose of availment of CENVAT Credit within 6 months of the date of issue of any of the documents is prospective in operation and shall not be applicable to the documents issued prior to the said date.

Disciplinary Case

Issuance of certificates regarding pending shipping bills without proper verification -- Held, Respondent is GUILTY of professional misconduct falling within the meaning Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949.

Held:

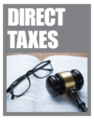
In the instant case, the charge against the Respondent is that the "Company" has submitted negative statements (certificates) regarding pending shipping bills for realization of export proceeds issued by the Respondent for the period from 01.01.2007 to 30.06.2010. However, as per XOS statement issued by the Reserve Bank of India, Mumbai, four shipping bills (were shown as pending for realization against the same party for the same period for which negative statement was issued by the Respondent. The Committee noted that the Respondent had issued various certificates for the relevant period certifying exports of the Company for export shipments. Although it is noted that XOS statement of RBI has not been made available by the Informant to the Committee, however, upon perusal of the challan for payment and SBI's certificates dated 05th December, 2013, it is noted that there were four pending bills. The Respondent pleaded that the certificates were issued by relying upon the data and documents furnished by internal CA. of the Company and other Directors. The Respondent also stated that he had carried out random checks as the volume of papers was very high. The Committee in this regard referred to provisions of "Guidance Note on Audit Reports and Certificates for Special Purposes" (pre-revised) wherein it has been stated that "*A reporting auditor should appreciate the difference between the terms 'certificate' and 'report'. A certificate is a written confirmation of the accuracy of the facts stated therein and does not involve any estimate or opinion. A report, on the other hand, is a formal statement usually made after an enquiry, examination or review of specified matters under report and includes the reporting auditor's opinion thereon. Thus, when a reporting auditor issues a certificate, he is responsible for the factual accuracy of what is stated therein….*"

Thus, in the light of above noted facts on record, challans for payment and certificate of SBI dated 5th December, 2013, the defence of the Respondent that he merely certified based on records produced by the Company through another CA is not acceptable and accordingly, the Committee held him guilty of professional misconduct falling within the meaning Clause (7) of Part I of the Second Schedule to the Chartered Accountants Act, 1949 for issuing the alleged certificates without applying professional skepticism and due diligence.

File No. : [PR/P/70/2014/-DD/48/INF/2014/DC/558/2017] CA. Yuvraj Kumar Agarwala

Circulars/Notifications

Given below are summarised important Circulars and Notifications issued by the CBDT, CBIC-GST and FEMA since the publication of the last issue of the journal, for information and use of members. Readers are requested to use the citation/website or weblink to access the full text of desired circular/ notification. Suggestions on this column can be submitted at eboard@icai.in



I. NOTIFICATIONS

1. Government notifies 'Public Investment Fund' under section 10(23FE) - Notification No. 125/2022, dated 16-11-2022

In exercise of powers conferred by sub-clause (vi) of clause (b) of Explanation 1 to section 10(23FE), the Central Government vide this notification has specified the sovereign wealth fund, namely, Public Investment Fund (PAN: AAAJP1787D), as the specified person in respect of the investment made by it in India on or after 16.11.2022 but on or before 31.03.2024 subject to the fulfilment of the conditions as laid therein.

The detailed Notification can be downloaded from the link below:

https://incometaxindia.gov.in/communications/notification/notification-125-2022.pdf

2. Government notifies 'the Federation Internationale de Football Association', as the specified person for the purpose of exemption u/s 10(39) - Notification No. 126/2022, dated 30-11-2022

Vide this Notification, the Central Government has notified u/s 10(39): (a) 'Federation Internationale de Football Association Under-17 Women's World Cup, 2022' as the international sporting event; and (b) income arising from the receipts from National supporters (as specified) amounting to Rs 12,50,00,000/- as specified income arising to that Association from organising such international sporting event in India.

The detailed Notification can be downloaded from the link below:

https://incometaxindia.gov.in/communications/notification/notification-126-2022.pdf

3. Partial relaxation with respect to electronic submission of Form 10F by select category of taxpayers in accordance with the DGIT (Systems) Notification No. 3/2022 - F. No. DGIT(S)-ADG(S)-3/e-Filing Notification/Forms/2022/9227, dated 12-12-2022

Vide this Notification, Partial relaxation is provided to Non-residents not having PAN and not required to have it under the provisions of Income-tax Act, 1961. They can file Form 10F manually till 31.03.2023 instead of electronically as being allowed prior to issuance of DGIT(System) Notification No. 03/2022 dated 16.07.2022.

The detailed Notification can be downloaded from the link below:

https://incometaxindia.gov.in/communications/notification/notification-e-filing.pdf

II. CIRCULARS

1. Income-tax Deduction from salaries during the Financial Year 2022-23 under section 192 of the Income-tax Act, 1961 - Circular No. 24/2022, dated 07-12-2022

This CBDT Circular contains the rates for deduction of income-tax from the payment of income chargeable under the head "Salaries" during the financial year 2022-23 and explains certain provisions of the Income-tax Act, 1961 and Income-tax Rules, 1962, including the broad scheme of TDS from Salaries, persons responsible for deducting tax at source from Salaries and their duties, computation of income under the head "Salaries" etc.

The detailed Circular can be downloaded from the link below:

https://incometaxindia.gov.in/communications/circular/circular-24-2022.pdf

III. PRESS RELEASES/INSTRUCTIONS/ OFFICE MEMORANDUM/ORDER

1. Income Tax Department conducts search actions in Karnataka

ITD initiated Search & Seizure actions on 20.10.2022 and 02.11.2022 on certain individuals who had executed Joint Development Agreements (JDAs) with various real-estate developers. The search action covered more than 50 premises spread across Bengaluru, Mumbai and Goa.

{Press Release, dated 17-11-2022}

The complete text of the above Office Order can be downloaded from the link below:

https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1121/Press-Release-ITD-conducts-search-actions-in-Karnataka-dated-17-11-2022.pdf

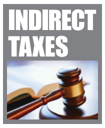
2. Search and seizure action by Income Tax Department in Bihar

ITD initiated a Search & Seizure action on few groups engaged in the business of gold & diamond jewellery and real estate on 17.11.2022. The searches were carried out at more than 30 premises spread over Patna, Bhagalpur, Dehri-on-Sone, Lucknow and Delhi.

{Press Release, dated 22-11-2022}

The complete text of the above Office Order can be downloaded from the link below:

https://incometaxindia.gov.in/Lists/Press%20Releases/Attachments/1122/PressRelease-Search-and-seizure-action-by-ITD-in-Bihar-22-11-22.pdf



GST

Notifications

1. Empowering the Competition Commission of India to handle Anti-Profiteering cases under the CGST Act

Central Government on the recommendations of GST Council has empowered the Competition Commission of India (CCI) established under section 7(1) of the Competition Act, 2002 to examine whether input tax credits availed by any registered person or the reduction in the tax rate have actually resulted in a commensurate reduction in the price of the goods or services or both supplied by him.

The above amendment has become effective from 01.12.2022.

Notification No. 23/2022-CT dt. 23.11.2022

2. Amendments in the CGST Rules, 2017

Consequent to the appointment of Competition Commission of India as the authority for anti-profiteering cases under the GST law, the provisions related to Anti-Profiteering Authority as provided under the CGST Rules, 2017 have been amended as under:

The following rules have been omitted:

(i) Rule 122: Constitution of the Authority.

(ii) Rule 124: Appointment, salary, allowances and other terms and conditions of service of the Chairman and Members of the Authority

(iii) Rule 125: Secretary to the Authority

(iv) Rule 134: Decision to be taken by the majority

(v) Rule 137: Tenure of Authority

Further, rule 127 which provides for 'Duties of the Authority' has been amended to substitute the word 'Duties' with the word 'Functions'.

Furthermore, in the Explanation provided after rule 137, the meaning of 'Authority' has been amended to mean the authority notified under sub-section (2) of section 171 of the Act.

The above amendments have become effective from 01.12.2022.

Notification No. 24/2022-CT dt. 23.11.2022

3. Extension of time limit for furnishing Form GSTR-1 for certain States of Tamil Nadu

The due date for filing GSTR-1 for the month of November 2022 for the registered persons whose principal place of business is in the districts of Chennai, Tiruvallur, Chengalpattu, Kancheepuram, Tiruvannamalai, Ranipet, Vellore, Villupuram, Cuddalore, Thiruvarur, Nagapattinam, Mayiladuthurai and Thanjavur in the State of Tamil Nadu was extended till the 13th day of the succeeding tax period.

Notification No. 25/2022-CT dt. 13.12.2022

CUSTOMS

1. Extension of the date for exemption of deposits from the provisions of section 51A of Customs Act, 1962

Section 51A of the Customs Act, 1962 provides that every deposit made towards duty, interest, penalty, fee or any other sum payable by a person under the provisions of this Act shall be credited to electronic cash ledger of such person. However, by exercising the power conferred under sub-section (4) of section 51A of the Customs Act, 1962, CBIC had exempted the deposits pertaining to all classes of persons and all categories of goods from the provisions of section 51A.

The above amendment which was made effective upto 29th November, 2022 has been extended to 31st March, 2023.

Notification No.98/2022-Customs (N.T) dt. 29.11.2022

2. Further extension of time limit for exemption of certain deposits from the provisions of section 51A of Customs Act, 1962

Section 51A of the Customs Act, 1962, states that every deposit made towards duty, interest, penalty, fee or any other sum payable by a person under the provisions of this Act shall be credited to electronic cash ledger of such person. However, exercising the power conferred under section 51A(4) of the Customs Act, 1962, CBIC had exempted the following deposits from the provisions of section 51A:

- Deposits with respect to goods imported or exported in customs stations where customs automated system is not in place.
- Deposits with respect to accompanied baggage
- Deposits other than those used for making payment of
  - any duty of customs, including cesses and surcharges levied as duties of customs

- integrated tax
- GST Compensation Cess
- interest, penalty, fees or any other amount payable under the said Act, or the Customs Tariff Act, 1975

The above amendment was made effective from 1st June, 2022.

Earlier, the date of 1st June 2022 was extended to 30th November vide *Notification No. 48/2022-Customs (N.T.) dt. 31.05.2022*.

Now, it has been further extended to 1st April, 2023.

Notification No. 99/2022-Customs (N.T.) dt. 29.11.2022

3. **Amendment in 'Exports by Post Regulations, 2018'**

Regulation 3(1) of Exports by Post Regulations, 2018 has been amended vide Exports by Post (Amendment) Regulations, 2022 to substitute the words "international credit and debit cards and as specified" with "various electronic means and in accordance with the guidelines issued".

Notification No. 103/2022-Customs (N.T.) dt 09.12.2022

4. **Introduction of Postal Export (Electronic Declaration and Processing) Regulations, 2022**

The Postal Export (Electronic Declaration and Processing) Regulations, 2022 shall apply to export of goods by any person, holding a valid Import-Export Code issued by the Director General of Foreign Trade, in furtherance of business through a foreign post office appointed by the Board. It shall be applicable from the date of its publication in the official gazette.

The guidelines related to the following have been discussed in the notification:

(i) PBE (Postal Bill of Export) Automated System and registration thereupon (a system operated and maintained by the postal authorities for filing of electronic declaration by exporter or his authorised agent)

(ii) Electronic declaration for postal export

(iii) Post offices for handling postal export

(iv) Clearance of goods for export at foreign post office

(v) Retention of records

(vi) Role and responsibilities of authorised agent

(vii)Penalty

Notification No. 104/2022-Customs(N.T.) dt. 09.12.2022

In order to bring more clarification on the above regulation, *Circular No. 25/2022-Customs dt. 09.12.2022* has been issued.

FEMA Updates

Hedging of Gold Price Risk in Overseas Markets

A.P. (DIR Series) Circular No. 19 dated December 12, 2022

Resident entities in India are currently not permitted to hedge their exposure to price risk of gold in overseas markets. On a review, it has been decided to permit eligible entities to hedge their exposure to price risk of gold on exchanges in the International Financial Services Centre (IFSC) recognised by the International Financial Services Centres Authority (IFSCA).

The Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022 (A. P. (DIR Series) Circular No. 21 dated December 12, 2022) have been issued for the same and can be viewed at below link: https://rbidocs.rbi.org.in/rdocs/Notification/DFs/153MDHEDGINGPRICE70DC397D54B641B0971E90A17EB4B97F.PDF

Hedging of Commodity Price Risk and Freight Risk in Overseas Markets

A.P. (DIR Series) Circular No. 20 dated December 12, 2022

Within the contours of the Foreign Exchange Management (Foreign Exchange Derivative Contracts) Regulations, 2000 dated May 3, 2000 (Notification No. FEMA. 25/RB-2000 dated May 3, 2000), the Reserve Bank issues directions to Authorised Persons under Section 11 of the Foreign Exchange Management Act, 1999 (Act 42 of 1999). These Directions lay down the modalities for the AD Cat-I banks for facilitating hedging of commodity price risk and freight risk in overseas markets by their customers / constituents.

The Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022 are enclosed herewith. AD Cat-I banks may bring the contents of these Directions to the notice of their customers/constituents concerned.

The Master Direction – Foreign Exchange Management (Hedging of Commodity Price Risk and Freight Risk in Overseas Markets) Directions, 2022 can be viewed at below link: https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/153 MDHEDGINGPRICE70DC397D54B641B0971E90A17EB4B97F.PDF

Matter on Direct and Indirect Taxes is contributed by Direct Taxes Committee, GST & Indirect Taxes Committee of ICAI respectively. FEMA updates by CA. Manoj Shah, CA Hinesh Doshi and CA. Sudha G. Bhushan.

Virtual Certificate Course on Concurrent Audit of Banks

The concurrent audit system of banks has become very crucial and important for banks. The main objective of the system is to ensure compliance with the audit systems in banks as per the guidelines of the Reserve Bank of India and importantly, to ensure timely detection of lapses/ irregularities. In view of the core competence of the chartered accountants in the area of finance and accounting, risk management, understanding of the internal functioning and controls of banks, etc., the banking sector has been relying extensively on them to comply with these requirements of the regulator. The Internal Audit Standards Board of ICAI conducts 11 days Certificate Course on Concurrent Audit of Banks through Digital Learning Hub. The purpose of the ***Certificate Course on Concurrent Audit of Banks*** is to provide an opportunity to the members to understand the intricacies of concurrent audit of banks thereby improving the effectiveness of concurrent audit system in banks, and also the quality and coverage of concurrent audit reports.

The course is open for the members of the Institute of Chartered Accountants of India

Please refer link for further details of the Course: https://www.icai.org/post.html?post_id=15262

FEES DETAILS: Rs. 5,900/- (including GST)

The details of the forthcoming batches of the Virtual Certificate Course on Concurrent Audit of Banks to be organized by the Internal Audit Standards Board through Digital Learning Hub is as follows:

Location	Scheduled Dates	Course Structure and other details
BATCH 85	January 3 - 13, 2023 (3:00 to 6:00 PM)	Structured_IASB_Certificate Course Concurrent Audit of Banks BATCH - 85
BATCH 86	January 18-29, 2023 (3:00 to 6:00 PM)	Structured_IASB_Certificate Course Concurrent Audit of Banks BATCH - 86

Chairman
Internal Audit Standards Board, ICAI
E-mail: cia@icai.in;

Study on Compliance with Financial Reporting Requirement (Ind AS Framework) Volume II

(Pages 142+ 16 initial pages+ 2 cover pages)

The Financial Reporting Review Board has recently released the Volume II of 'Study on Compliance with Financial Reporting Requirement (IND AS Framework) with an objective to educate the preparers of financial statements, auditor and other members about the compliance with various financial reporting requirements thus paving the way for enhancing the quality of the financial statements as well as quality of services rendered by the members.

Significant features of this publication are:

- This publication contains pertinent observations of the Board in context of Ind AS, Standards on Auditing, applicable Guidance Notes as well as other relevant Laws and Statutes.
- For easy reference, the observations have been classified elements of financial statements wise viz, Observations related to 'Assets', 'Equity', 'Liabilities', 'Components of Profit and Loss', 'Statement of Cash Flows', 'Other Disclosures', 'Auditor's Report' and 'CARO' which should be complied with while preparing the financial statements or expressing opinion thereupon.
- The publication is written in simple and easy to understand language alongwith reference to various reporting requirements.
- Contains graphical presentation on 'Deficiencies Observed: At a Glance'. It exhibits level/ percentage of non-compliances observed in all the Indian Accounting Standards (Ind AS). It also contains pie chart 'Deficiency observed: Elements of Financial Statements' shows percentage of non-compliances observed in each element of financial statements.

Price: Rs. 300

Ordering Information

The publication can be purchased directly from the ICAI Central Distribution System (CDS Portal) by signing up and placing order on online store through following link: https://icai-cds.org/

To order by post, requisition may be sent to the Postal Sales Department of the ICAI at postalsales@icai.in.

CAMPUS FOR NEWLY QUALIFIED CHARTERED ACCOUNTANTS (NQCAs) FEBRUARY - MARCH, 2023

Maintaining strong and spontaneous relationship with the industry and other business houses remains the main focus of the **Committee for members in Industry & Business (CMI&B)** of **The Institute of Chartered Accountants of India** (ICAI). An initiative to that effect remains the Campus Placement Programme (held twice a year) that provides a platform to both the NQCAs and the organizations looking for to hire the best available talents to fulfil their human resource requirement. ICAI simply acts as afacilitator to bring the recruiter and NQCAs together.

Invitation to Organisations- Any corporation, irrespective of its size, standing in the market and boundary of its business, can take part in this placement programme being held at 27 centers across the country during February- March, 2023.

Campus Interview Schedule (Virtual):

S.No.	Centre	Dates
1	Mumbai	21st, 23rd, 27th February, 2023, 1st, 6th & 10th March, 2023
2	Delhi	22nd, 24th, 28th February, 2023, 2nd, 6th & 10th March, 2023
3	Bengaluru	23rd, 27th February, 2023, 1st, 3rd, 7th & 10th March, 2023
4	Chennai	24th, 28th February, 2023, 3rd, 7th, 9th & 13th March, 2023
5	Kolkata	28th February, 2023, 3rd, 7th, 9th, 13th & 15th March, 2023
6	Ahmedabad, Hyderabad, Jaipur & Pune	1st, 7th, 9th, 13th, 15th & 17th March, 2023
7	Durgapur, Nagpur, Rajkot, Lucknow, Raipur, Bhopal, Ernakulam, Visakhapatnam, Patna, Vadodara & Ranchi	13th April 2023
8	Kanpur	14th & 17th April, 2023
9	Noida & Thane	17th & 19th April, 2023
10	Bhubaneswar, Chandigarh, Coimbatore & Indore	21st & 25th April, 2023

Invitation to Candidates: The above Campus is meant for the candidates, who would be passing the CA Final examination held in November, 2022 and also for others who have qualified earlier and are fulfilling the criteria mentioned in the announcement available on **https://cmib.icai.org/**.

Organizations intending to recruit NQCAs through campus scheme are requested to get in touch with the **CMI&B Secretariat, ICAI Bhawan, Indraprastha Marg, New Delhi -110002**, and Email: **campus@icai.in**, Tel No. (011) 30110555 and to register log on to **https://cmib.icai.org/**.

Candidates may email at **cajob@icai.in** , Tel No. (011)30110491/550 and to register log on to **https://cmib.icai.org/**.

Chairman & Vice Chairman
Committee for Members in Industry & Business
The Institute of Chartered Accountants of India

Organised By:
Committee for Members in Industry & Business (CMI&B)
The Institute of Chartered Accountants of India
(Set up by an Act of Parliament)
'ICAI Bhawan', Post Box No. 7100, Indraprastha Marg, New Delhi - 110002
Website: www.icai.org

Glimpses of Press Clippings published in November- December 2022

madhya pradesh
absoluteindia
Delhi & Bhopal, Sunday, December 11, 2022

Important role of chartered accountants in the economy: Governor Patel

Governor participates in the program of Institute of Chartered Accountants of India

Team Absolute | Bhopal

Governor Mangubhai Patel has said that chartered accountants play an important role in the economy. The contribution of chartered accountants is important in the purity and welfare nature of the economy. Governor Shri Patel was addressing the Institute of Chartered Accountants of India program at Samanvaya Bhavan.

Patel said that the Parliament, the holy institution of our republic, has given the right to check and audit the books of accounts only to chartered accountants. In a way, they have been given the important responsibility of being the protectors of the most vulnerable and deprived sections of the society. The Governor said that the competence of Chartered Accountants is not limited to examining the propriety of its purpose on the basis of various aspects of prudence, integrity and economy.

Governor Patel said that the financial expertise of chartered accountants is meaningful only in providing the right direction to various subjects related to tax, capital and budget planning and preparation of financing accounting books on a large scale in nation building. He said that it is the responsibility of Chartered Accountants to ensure proper utilization of national resources for the welfare of the poor and deprived sections.

Governor Patel said that strict standards of audit should be followed carefully. Similarly, the role of Chartered Accountants is crucial in providing credibility to financial market transactions, as markets, participants, investors and shareholders look to Chartered Accountants for high quality information.

TIMES CITY
SUNDAY TIMES OF INDIA, AHMEDABAD
NOVEMBER 27, 2022

Under NEP, CA exam structure to change: ICAI

Times News Network

Ahmedabad: Fewer question papers and a reduction in the duration of articleship are among the highlights of the chartered accountancy courses under the new education policy (NEP). This was shared by the educational experts at a mega career counselling camp held by the Institute of Chartered Accountants of India (ICAI) at Gujarat University convention centre on Saturday.

"Under the NEP, students of the CA foundation course will have four question papers whereas those enrolled in CA intermediate and CA final courses will have six question papers compared to eight earlier. Earlier, CA students had to undergo a three-year articleship which has been reduced to two years," Aniket Talati, the vice president of ICAI said in a statement.

Talati said that a self-paced module will be introduced next year; the students will have to take four exams between intermediate and CA final. Talati said that these exams are aimed at honing students' skills. The new course format is likely to be in place by May 2023 or latest by November 2023.

Talati said that students who drop out before the final exams will be given a Business Accounting Associate degree. He said that this will enable such students to work as assistants to CAs and pursue a career in accountancy.

mint
Thursday, 8 December 2022, Chennai

Digital assurance will boost audit quality: ICAI president

Gireesh Chandra Prasad
gireesh.p@livemint.com
NEW DELHI

Accounting rule-maker Institute of Chartered Accountants of India (ICAI) is taking steps to scale up sustainability reporting and improve the quality of financial statements and audits.

ICAI President Debashis Mitra said the Institute will regulate social auditors, mandate how accountants should verify information supplied by managements and where it concurs and differs with key audit reform proposals under discussion in government. *Edited excerpts:*

What are the steps on the table to improve audit quality?

We are now preparing a technical guide on digital assurance for third party confirmation. This I think will come up before the ICAI Council on 15 December. That is very important. For example, bank statements: an auditor needs to have assurance whether the bank balance is right or not. He will get the ID of the client's bank account, go to the bank account, and check all bank transactions. These are all third-party assurance. The bank is the third party for the auditor. The auditor wants to verify the bank transactions. Auditors also wants to verify GST transactions—how much is the sale as per GST transactions and whether the sale tallies with the sale shown in its profit and loss account. Auditor goes to the GST site (of GSTN, the company that processes GST returns) and checks the sales shown there and finds whether that tallies with the sale (shown in P&L account). Here GSTN is the third party.

For this, will the auditor have to get access to these accounts?

Yes. They (auditee) will have to provide the auditor access to these sites. Everybody says auditor cannot solely rely on client's statements, they should verify things themselves. This is very important. The quality of audit will certainly improve and the reliability of financial statements will certainly improve. Our technical guide will tell auditors how to do digital assurance.

> To regulate profession of social audit, we formed the Indian Institute of Social Auditors, under section 8 of Companies Act
>
> **Debashis Mitra**
> ICAI President

This will help to prevent Satyam-like scandals?

Absolutely.

What are the steps being planned for improving sustainability reporting?

We have developed 16 social audit standards and to regulate the profession of social audit, we have formed the Indian Institute of Social Auditors, under section 8 of the Companies Act. As per Sebi, the regulation of entire profession of social audit will be done by ICAI. In a social stock exchange, non-government organizations will be able to raise funds. But the contributors would like to know about the utilization of those funds.

The social auditor checks if the money raised has been utilized properly. The Indian Institute of Social Auditors will regulate these auditors and take disciplinary action wherever warranted. National Institute of Securities Market (NISM), a public trust set up by Sebi, conducts the qualifying exam for social auditors. NISM is developing the curriculum in consultation with ICAI.

ICAI in Media

20 t2 THE TELEGRAPH WEDNESDAY 7 DECEMBER 2022

TT Connect Initiative

The Institute of Chartered Accountants of India

ICAI – An Outstanding Accounting Educator

The ICAI is constantly incorporating national and global best practices in its education system, churning out quality Chartered Accountant professionals.

By providing aspiring chartered accountants with the necessary competencies through enriched learning methodologies, cogent and holistic skill assessments, effective and focused practical training, industry orientation, and multidisciplinary approach, the Scheme of Education and Training of the Institute of Chartered Accountants of India (ICAI) seeks to create professionals who are 'global ready'.

Rigorous academic training

The academic training provided by the Institute of Chartered Accountants of India (ICAI) is crucial in helping aspiring Chartered Accountants understand their responsibilities and efficiently carry them out once they join the profession. In this situation, it wouldn't be an exaggeration to claim that the ICAI's Examinations have a long history of being among the most rigorous professional exams. The ICAI ensures that qualified Chartered Accountants possess the competence that stakeholders, employers, and clients expect of them through its top-notch programme of education and training and strong assessment process.

Providing holistic education

When a special committee was established in 1959 to look into several concerns relating to admittance into the Chartered Accountancy profession and its training system, the process of reviewing the ICAI's Scheme of Education and Training began. The Committee for Review of Education and Training (CRET) that has been constituted last year uses a multi-pronged approach to evaluate the key elements of the Scheme of Education and Training and make the necessary adjustments to bring them into compliance with the National Education Policy, 2020 (NEP, 2020), International Education Standards (IESs) of IFAC, best practises of professional accountancy organisations (PAOs), and current and future economic and societal demands.

> The ICAI ensures that qualified Chartered Accountants possess the competence that stakeholders, employers, and clients expect of them through its top-notch programme of education and training and strong assessment process.

Evolving with the times

The ICAI is aware that the position of a CA is evolving significantly to take on fresh obligations in a fast-paced environment, and that there has been a clear movement toward strategic decision-making and entrepreneurial roles that bring value beyond financial recording and reporting. The ability of the CA educational system to satisfy the wide range of needs of numerous stakeholders become the main focus in the described dynamic scenario. Therefore, it was deemed necessary to establish, update, and offer Chartered Accountancy education and training using a completely new methodology. As a result, CRET was established in March 2021.

> One of the unique features of the new scheme that will help aspiring CAs achieve the desired level of professional competence is technology-enhanced learning through self-paced online modules, a required paper on a multi-disciplinary case study with an open book pattern of assessment, and seamless practical training.

Improving educational experience

President, ICAI added "The New Scheme contains quality elements to build strategic chartered accountants by providing them with the necessary abilities, carrying on CRET's multi-pronged strategy in this area." One of the unique features of the new scheme that will help aspiring CAs achieve the desired level of professional competence is technology-enhanced learning through self-paced online modules, a compulsary paper on a multi-disciplinary case study with an open book pattern of assessment, and seamless practical training. These additional features would improve the educational experience and efficiently evaluate an aspirant chartered accountant's acquisition of interdisciplinary knowledge and abilities.

With these new features incorporating the best practises from around the world, ICAI will work to make sure that the resulting structure is dynamic, modern, and appropriate for the needs of the global economy.

THE HINDU
Wednesday, 21 December 2022, Chennai

ICAI MSME YATRA ENTERS INDIA BOOK OF RECORDS FOR MAXIMUM PROGRAMMES IN MAXIMUM CITIES

The Committee on MSME & Start-up of the Institute of Chartered Accountants of India (ICAI) entered into the INDIA BOOK OF RECORDS for covering MSME programmes in the maximum number of cities during ICAI MSME Yatra & Setu. This feat was achieved, when ICAI conducted a nationwide 'ICAI MSME SETU' and 'ICAI MSME YATRA' under the backdrop of 'Azadi Ka Amrit Mahotsav' covering 75 cities across 22 states of the nation in 75 days for promoting entrepreneurship as well as to boost job creation and develop the economy. The campaign was held from August 18, 2022 till November 18, 2022.On this remarkable achievement, CA. (Dr.) Debashis Mitra, President, ICAI said "ICAI is immensely proud and happy to receive this honour to be inducted in the prestigious India Book of Records for our MSME Yatra & Setu initiative. I wholeheartedly thank and congratulate ICAI Regional Councils, Branches and others who actively participated in this campaign to support MSME ecosystem in the country. ICAI is always committed to work towards empowering MSME and start-up sector in the country to boost the economy and drive positive change in the society." With Government launching various schemes to strengthen Indian MSMEs and bolster them on Global Map, ICAI too, as a true partner-in-nation-building joined hands with the Government and has taken several initiatives to enhance the capacity building measures of MSMEs & Start-ups in India. A few such initiatives are, launch of ICAI MSME Exchange, ICAI MSME Portal, Certificate & Refresher Course on MSME, Knowledge Enhancement State Specific Books/Booklets on MSMEs, ICAI MSME Setu Programme i.e. Transformation of MSMEs, MoUs with the various government agencies for the enhancement of the portfolio of MSMEs & other endeavours for the Capacity Building of MSMEs.

Strengthening the

Economy

with

Excellence, Independence and Integrity

ABOUT ICAI

The Institute of Chartered Accountants of India (ICAI) was established by an Act of Parliament in 1949 and since inception has proven its mark as an elite institution devoted to uphold the values of transparency, accountability and integrity. It has indeed come a long way, be it in terms of numbers, skills & utilities, recognition from society, or its role in nation building.

PROFESSIONAL COMPETENCE

- More than 10 Lakh Members & Students
- 166 Branches, 44 Overseas Chapters & 33 Representative offices
- Promoter of Values, Virtues & Vision of Excellence
- Robust Regulator & Developer of Trusted Professionals
- Sharing Knowledge to Shape Policies
- Trusted Partner with Government Initiatives
- An Educator Par Excellence - Keeping Pace with New Era of E-learning
- Placing Indian CAs at Global Pedestal by entering into Mutual Recognition Agreements (MRAs) with Global Accounting Bodies

THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

(Set up by an Act of Parliament)

www.icai.org

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