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The Institute of Chartered Accountants of India
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Chartered Accountant Student

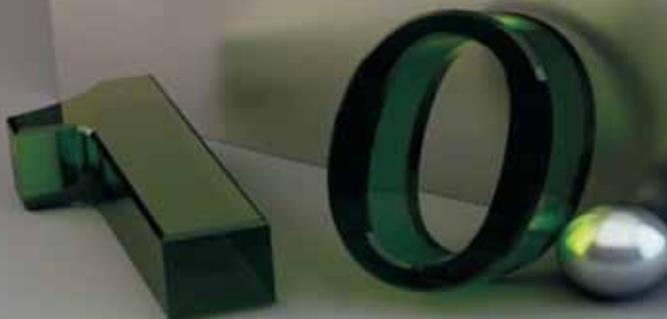
Your Monthly Guide to the CA News, Information & Events

STUDENTS' JOURNAL

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President's Communication

Dear Students,

I on behalf of the Institute of Chartered Accountants of India feel really elated to convey my best wishes to all of you for a very prosperous and happy **New Year 2011**. I pray to Almighty that the blissful occasion of New Year brings with it new hopes and opportunities to explore new vistas of professional and personal success. Let's resolute and regard New Year as a fresh opportunity for the betterment and to set a benchmark for the Accounting Profession. I also extend my warm greetings on the occasion of **61st Republic Day** of our nation.

I know that you may be eagerly waiting for the declaration of the results of **November 2010 CA Examinations**. My best wishes are with you and I hope that you will be able to achieve success with flying colors. I can easily understand the importance of the results of this examination as it will maneuver all your professional endeavours. I hope that the new pattern of the question papers could have provided you ample opportunities to tackle the paper in a judicious manner. I strongly believe that a sincere and committed approach towards Articleship training will steer your path to understand the basic and core concepts of theoretical subjects as well.

I would like to inform you that the Council at its 300th

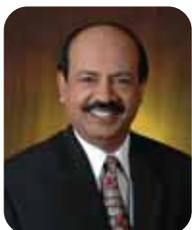
meeting reviewed the requirement for passing the Common Proficiency Test and decided that a candidate shall have to obtain at one sitting, a minimum of 30 per cent marks (out of maximum marks specified by the Council for each Section) and a minimum of 50 per cent marks in the aggregate of all the Sections, subject to the principle of negative marking, in a manner as may be specified by the Council from time to time subject to proposed amendments in the regulations approved by the Central Government. The Institute has been receiving several queries from the students, their parents and members seeking clarification in this regard as when it will be made effective. I would like to clarify that the decision of the Council will be made applicable only after the Chartered Accountants Regulations, 1988 are amended and approved by the Central Government, for which a proposal will be sent to the Central Government shortly.

I feel happy that our Institute is all set to launch its IT enabled pilot project of **Live Virtual Class** in a short span of time. I am very confident that this initiative will serve as a supplement to our distance learning programme and through this programme you will be having a life time learning opportunity to interact with eminent faculty members to widen your professional horizon.

Wish best wishes for a happy future ahead

Yours sincerely,

CA. Amarjit Chopra
President, ICAI, New Delhi



Vice-president's Communication

Dear Students,

At the outset, I would like to extend my heartiest wishes for a wonderful and prosperous **New Year 2011**. I am pretty sure that the New Year will provide our CA student fraternity to scale new heights of success in all their professional endeavours. I really feel proud and honoured that in each passing year our Institute is creating ripples and gaining strength from strength in the arena of accounting profession. We have great onus on our shoulders to restore the core values of accounting profession. I think New Year is the most suitable time for all us to pledge that we will serve our society with utmost sincerity, honesty, transparency and thereby contribute in the overall development of the nation. In this month, the results of your **November, 2010 Examinations** would be declared. I express my best wishes for the same and hope that maximum numbers of candidates pass the preceding examinations.

I feel immense pleasure to extend my best wishes on the occasion of **61st Republic Day** of our beloved motherland. The celebration of this day instills such a patriotic fervor that truly reflects our unity amidst diversity. We salute our freedom fighters who sacrificed their invaluable lives to redeem our country from the bondage of foreign rule. I hope that in our motherland peace and prosperity will prevail

forever. Undoubtedly, the country is marching robustly to become monarch of the inclusive economic growth where gross domestic product is almost touching 9%. It is really a merry time for overall development of India as the economies of the developed countries are staggering to stay intact after facing the critical period of economic doldrums.

We are all geared up to provide you world class learning ambience and facilities as to cater to the requirements of changing professional world. In the present day scenario, along with hard skills, a strong hold on soft skills is imperative to sail through the competitive world successfully. Board of Studies organizes several programmes to sharpen your communication skills. The 2nd batch of Six-week residential programme on Professional Skills Development Course is in progress. The course is being held at the Centre of Excellence, Hyderabad. The Board of Studies has proposed to run these batches on continuous basis. The third batch of this high esteem programme will start from January 20, 2011. So far we have received unprecedented response from the students and I hope that you will enroll in large numbers to obtain benefit from such programmes.

With best wishes

Yours sincerely,

CA. G. Ramaswamy
Vice-President, ICAI, New Delhi



Message From The Chairman, Board of Studies

Dear Students,

I had the pleasure of visiting several cities during December to take part in various national levels, state level and regional level conferences where CA students participated in larger numbers.

I have taken promise from all the students in various conferences to, work hard, follow strict discipline, have firm commitment to definitely pass the CA examination and to have a long term vision for a successful career as a CA. The students' community has also committed to ensure that they will work towards building in themselves core professionals of international standards. Rather than concentrating only on passing, CA students should also concentrate on personality development, independence, integrity, excellence and ensure adherence to core ethical values. The CA Students also took a special pledge to fight against menace of corruption.

ICAI Shiksha Live

The Institute of Chartered Accountants of India is launching nationwide live classes on the basis of 2-way video conference technology on 28th December, 2010 at about 25 centers all across the country. The number of centers to be covered will be gradually and swiftly expanded to about 250 centers in all major towns and cities.

ICAI will provide best faculties chosen from Delhi, Mumbai, Chennai, Kolkata, Ahmedabad, Bangalore, Hyderabad and other important centers of education. The faculties will include topmost and best teachers, lecturers and professors as well as top practitioners in the respective fields. The lecturers will be supplemented by specialized experts from industry, Indian Institute of Management, XLRI, Sri Ram College of Commerce, Xavier's and other leading Institutions. ICAI has received the consent of a large number of top faculties to provide their time and efforts to give lectures and share their knowledge through case studies, special tutorials, periodical tests and live visuals.

The students will be required to attend the aforesaid live classes, to be known as **ICAI Shiksha Live in the class rooms**. These will be organised in various ICAI buildings and premises of various service providers. The Live Classes will also be manned with local faculties to

provide necessary guidance and to sort out routine problems and queries besides supplementing guidance from expert national level faculties. In a gradual manner, the coverage of the classes will be for all subjects and all courses including CPT, IPCC as well as CA final.

I sincerely look forward for the support of the students' community, academicians and experts for this noble cause of providing education at a significantly low cost.

ICAI study Material, Text Books and Reference books

I also wish to call upon the students' community to comprehensively study, the study materials given by the Institute and relevant text books of eminent and reputed authors from India as well as from abroad on all the subjects covered in the syllabus. This will ensure comprehensive knowledge and will empower the students to pass the examination in a more confident manner. It may be noted that IPCC material has been substantially revised and CA Final material as comprehensively revised will be made available in January 2011. **I encourage the students to buy the revised edition in their own interest.** The same will also be hosted in students' knowledge portal at ICAI website.

International Recognition

ICAI has a vision to make our qualification truly international. The mutual recognition agreements have been signed with the Institute of Chartered Accountants of English and Wales, Ireland, Australia and the Institute of Certified Public Accountants Australia. The MRA with Canada is in advanced stage of finalization. Similar negotiations are on with US and Singapore.

International reach of Indian CA Education

ICAI also wishes to provide its education to Indians who have settled in various parts of the world for generations. Also, we wish to make our education available to foreign nationals spread over 100 plus countries. The necessary preparations and consensus building for regulatory clearance have commenced and it is expected that a shape to this visionary exercise will be achieved in a very near future.

With Best Wishes for a Happy and Prosperous New Year

Yours sincerely,

CA. Vinod Jain

Email : chairmanbos@icai.org

CA Student Enthralled at 16th Asian Games

Aishwaraya Nityananda, the Bangalore based CA Final student and a renowned young Bharathanatyam dancer performed Bharathanatyam at the cultural programme of 16th Asian Games held on 15th November 2010 at GUANG ZHOU, the flower city of China.

In the concert Music for Cultural Harmony, 24 Asian Countries displayed their country's rich cultural heritage. At the end of the cultural extravaganza Aishwaraya Nityananda performed with representatives of 24 other countries on a special composition of French composer Mr. ROMBI which depicts how



Music and Dance could bring various diverse cultures together in Harmony.

She performed Bharathanatyam in China at the invitation of ICCR, Government of India, New Delhi. She has given over 500 performances all over India and abroad including Canada and United States.

Aishwarya has been excelling in Academics also. She has the distinction of scoring

perfect '100' in commerce in her ICSE exams and distinction in college and also 'vidwathi' Exams in Bharathanatyam.

10th All India Quiz Contest and 16th All India Elocution Contest

The Board of Studies of the Institute is organizing the 10th All India Quiz Contest and 16th All India Elocution Contest on 12th January, 2011 as per the following details:-

Venue: : **The Institute of Chartered Accountants of India,**
"ICAI Bhawan"
Plot No. A-29, Sector-62,
Noida-201 309.

Time: : Quiz Contest - 9 a.m. to 1 p.m.
Elocution Contest - 1.30 p.m. to 6 p.m.

The participants to the Contests would be the winners of the Regional Level Contests held earlier by the respective Regions. C.A students from Delhi/New Delhi, Noida/Ghaziabad are invited to be part of the audience to encourage and cheer up the Contestants.

Students may please note that the land line numbers of Institute's office at Sector 62, Noida have been reverted back to ones at Institute's previous office at Sector 58, Noida i.e instead of 0120-39869..., they are 0120-30459..

So, the landline numbers for guidance from BOS are: 0120-3045930, 0120-3045931, 0120-3045908, 0120-3045959



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Service Tax on Deemed Construction

V S Datey



1 Background

The service tax provisions relating to construction services cover two types of services - (a) Commercial or industrial construction which is taxable w.e.f. 10-9-2004 and (b) Construction of complex (residential complex of more than 12 residential units) which is taxable w.e.f. 16-6-2005.

If works contract tax is payable on these construction activities, these services would get covered under 'works contract service' w.e.f. 1-6-2007.

Initially, there were disputes regarding services provided by a builder or a developer for construction of residential complex or commercial premises.

However, on basis of Court decisions and CBE&C circulars, it was more or less settled that a builder entering into contract for sale of flat or industrial unit (gala) or shop or a developer entering into contract for construction of an individual flat for personal residential use of client are not liable to pay service tax.

The basic reason is that the contract of customer with builder or developer is for sale of a ready flat or industrial unit or shop. It is not a construction contract i.e. it is not contract for provision of construction service.

1.1 Change made in Budget 2010

In the Finance Act, 2010, an *Explanation* has been added w.e.f. 1-7-2010, to the definition of 'commercial or industrial construction' and 'construction of residential complex', as follows -
Explanation.— For the purposes of this sub-clause, construction of a complex which is intended for

sale, wholly or partly, by a builder or any person authorised by the builder before, during or after construction (except in cases for which no sum is received from or on behalf of the prospective buyer by the builder or a person authorised by the builder before the grant of completion certificate by the authority competent to issue such certificate under any law for the time being in force) shall be deemed to be service provided by the builder to the buyer.

In case of commercial or industrial construction service, the words used are 'construction of a new building' in place of 'complex'. Otherwise, the wording is identical.

Thus, by a 'deeming provision', an activity which is not 'service' as per Court decisions and CBE&C's own earlier circulars will be a 'deemed service' for the purpose of levy of service tax.

Note that the *Explanation* being added is not a valuation provision.

For a man to write well, there are required three necessities: to read the best authors, observe the best speakers, and much exercise of his own style.

1.2 Effect of the change made by the explanation

The effect of the change is that the service tax will not apply *only* when a builder sales a ready flat or shop or industrial unit (*gala*) *after* Building completion certificate is obtained from local authority (like Municipal Corporation, Municipality, Gram Panchayat etc.) **and** *entire* consideration is obtained only after building completion certificate is obtained.

In all other cases, the builder will be liable to pay the service tax. It is well known that in most of the cases, builder constructs buildings mainly on raising funds from prospective buyers. Further, even after building is completed and ready for

The author is a noted writer and Consultant on Indirect Tax.

occupation, there is delay in obtaining building completion certificate from the authorities.

Thus, practically in all cases, the builder/developer will be liable to pay service tax, except in case of few flats or shops or commercial *galas*, which he usually keeps for sale at a later date at higher prices. Even in that case, the builder/developer will not be liable only if entire transaction (including receipt of money) takes place after obtaining 'completion certificate' from municipal or other competent authority.

1.3 Amendment does not apply to works contract service

The amendment will *not* apply if the contract is covered under works contract service i.e. where Vat/Sales tax is payable on the contract.

1.4 Authority to issue building completion certificate

Government has issued MF(DR) order No. 1/2010 dated 22-6-2010 for 'Removal of Difficulty'. The order is effective from 1-7-2010 and it clarifies that building completion certificate can be issued by Architect, Chartered Engineer or Licensed Surveyor who is authorised under any law for the time being in force, to issue a completion certificate in respect of residential or commercial or industrial complex, as a precondition for its occupation.

Comment – In most of the places, the completion certificate is issued by Municipal or Corporation authorities. In most of the cases, an Architect or a Chartered Engineer or Licensed valuer is not authorised by law to issue a completion certificate as precondition of occupation. Hence, practically, completion certificate issued by Architect or Chartered Engineer or Licensed Valuer will not be a valid certificate to determine whether building has been completed.

2 Transitory provisions

Issue arises in respect of projects already running on 1-7-2010. Issue is whether service tax will apply only in case of fresh bookings or will apply in case of earlier bookings also.

Really, date of booking is not relevant. Date of provision of service is relevant as provision of service is the taxable event. Hence, if construction service is provided after 1-7-2010, service tax will be payable, irrespective of date of booking.

The *Explanation* being added to the definition is only a 'deemed service provision' and not a valuation provision. It does not link payment received with tax liability.

2.1 Construction partly complete on 1-7-2010

Principally, provision of service is the 'taxable event', i.e. services provided after tax is imposed will be taxable. Thus, service tax will apply in respect of services provided or to be provided on or after 1-7-2010. Receipt of payment or advance is not relevant for determining tax liability. Thus, a builder/developer is not liable to pay service tax in respect of services provided upto 1-7-2010. Such bifurcation is possible only if the builder/developer keeps proper accounts and records.

It is highly advisable to issue invoices (running bills) in respect of services provided upto 1-7-2010 and/or obtain certificate from

Architect/Chartered Engineer regarding stage of completion of construction as on 1-7-2010.

If construction is fully complete before 1-7-2010, no tax is payable as service tax is on provision of service which is the taxable event. Receipt of payment does not decide tax liability.

If construction is complete but application for completion certificate is not yet submitted, there is no service tax liability if you establish that construction was completed before cut off date of 1-7-2010.

2.2 Advance paid by customer irrespective of completion certificate or possession before the cut off date i.e. 1-7-2010

As a general principle, tax liability will be on the basis of construction services provided on or after 1-7-2010 and not on the basis of advance received. Thus, normally, service tax is payable if service is rendered after 1-7-2010, even if advance was received prior to 1-7-2010.

A work that aspires, however humbly, to the condition of art should carry its justification in every line.

However, as per Notification No. 36/2010-ST dated 28-6-2010, in respect of service as per amended definition, if any advance payment was received prior to 1-7-2010, for service to be provided after 1-7-2010, service tax will be fully exempted *This is a good transitory relief to service providers as well as customers.*

Thus, if advance payment was received prior to 1-7-2010, service tax will not be payable even if service in respect of that advance is provided after 1-7-2010.

3 When service tax is payable

Service tax is payable when advance is received, even if actual service is to be provided later, but that is so only when service is a taxable service. Thus, if payment is received in respect of construction completed upto 1-7-2010 (even after 1-7-2010), service tax will not be payable.

Service tax is payable on receipt basis and hence as you get payment for construction service from your customer, you have to pay service tax on that amount. If service tax is not shown separately in bill or amount received, the amount received should be taken as inclusive of service tax and then back calculations may be made.

As explained above, service tax in relation to advance received prior to 1-7-2010 has been exempted vide Notification No. 36/2010-ST dated 28-6-2010. Hence, service tax will not apply even if the service is provided after 1-7-2010.

4 Liability of service tax when land owner is given some flats or shops free

In some cases, land is obtained from the land owner and some flats/galas (shops) are given to him free in lieu of the land.

The nature of agreement between land owner, builder/developer and customer (service receiver) varies from State to State. In some States (in Western and Northern India), the builder first enters into agreement with landowner and gets development rights and irrevocable power of attorney. The builder then enters into 'agreement to sale' with prospective customers. Final sale deed is executed only after building is complete and possession is handed over.

In some States (in Southern India), two separate agreements are executed – one between land owner

and customer and other between developer (service provider) and customer. The developer also has separate agreement with land owner where he agrees to give him some flats/galas (shops) free.

In both the cases, issue is whether builder/developer is providing any service to the land owner.

Section 67(1)(ii) of Finance Act, 1994, envisages consideration 'not wholly or partly consisting of money'. Thus, 'consideration' need not be in money form alone.

There is a view that relation between builder and land owner is not of 'service provider and service receiver' but that of 'quasi partner' or 'joint venture'. It is difficult to accept this view since in partnership sharing of profit and mutual agency are essential ingredients, while in joint venture, joint control and sharing of profit/loss are essential ingredients. These are totally absent in agreement between builder and land owner.

Hence, in my view, service tax will indeed be payable. In fact, as soon as the builder/developer gets possession of land from land owner, it is 'advance received' and service tax will become payable next month.

If we assume that agreement between builder and land owner is in nature of joint venture, liability of service tax will be on landowner if he sells flats or shops before obtaining completion certificate.

Of course, if builder/developer has already paid the service tax on that construction, the land owner can argue that all service tax on construction service has already been paid by builder/developer and there is nothing to pay now. He can also argue that he is neither builder nor a person authorised by him to sell the building or part of it.

If landowner is liable to pay service tax, valuation can be on basis of value of similar service or on cost plus reasonable profit, as provided in Rule 3 of Service Tax Valuation Rules.

5 Surrender of the booking by customer

If customer surrenders the booking and if builder/developer refunds the entire amount along with service tax to customer, then builder/developer can adjust the service tax in his subsequent payments of service tax. As per rule 6(3) of Service Tax Rules, if excess tax is paid, in respect of service which is

not provided either wholly or partially for any reason, the excess service tax paid can be adjusted against service tax payable for subsequent period, if the value of services and tax thereon is refunded to the person from whom it was received.

While giving refund, cancellation charges are usually deducted. These are really in nature of liquidated damages and not on account of service provided. Hence, in my view, entire service tax can be adjusted under rule 6(3) even if cancellation charges are deducted. However, it is a litigation prone issue and one must be ready to fight it out. If quantum is less, it may be economical to pay service tax instead of entering into litigation.

6 Valuation of service

Principally, service tax is payable on value of taxable services. This is also clear from the fact that 'preferential location and development of complex' has been specified as a different taxable service.

Thus, if a service provider has proper costing records, it is permissible to deduct value of material and land (or calculate value of service on cost plus profit basis) and pay service tax on value of service @ 10.30%.

If this is not feasible, then tax is payable @ 10.30% on 25%/33% of entire value of contract including material (used by builder plus supplied free of cost by customer), but then Cenvat credit is not available, as explained below.

Any person providing taxable service of commercial or industrial construction or construction of residential complex (except completion and finishing services like glazing, plastering, painting, tiling, wood and metal joinery and carpentry, swimming pools, acoustic applications etc.) can opt to pay service tax as follows (w.e.f. 1-7-2010) – (a) on 33% of gross amount charged if the gross amount *does not* include value of land

(b) on 25% of gross amount charged if the gross amount includes value of land (Till 1-7-2010, the 25% scheme was not available. Only 33% scheme was available).

This is at the option of service provider.

The 'gross amount' should include value of goods and materials *supplied or provided or used*. However,

he can avail this concession only if - (a) He does not avail Cenvat of duty/service tax paid on inputs, input services and capital goods *and* (b) He does not avail benefit of Notification No. 12/2003-ST dated 20-6-2003. - Notification No. 1/2006-ST dated 1-3-2006 as amended w.e.f. 1-7-2010.

The partial exemption is available only if the gross amount charged includes value of goods and materials supplied or provided or used for providing such service (*Explanation* to Notification No. 1/2006-ST]. Thus, if the customer provides some material, its value will have to be added for purpose of payment of service tax.

As per Notification No. 12/2003-ST, no service tax is payable on value of material or goods sold to recipient of service. Thus, if a service provider avails exemption under 12/2003-ST (i.e. claims deduction of value of material or goods from gross value of contract), he cannot avail composition rate of 33%/25% of gross amount charged to customers. *The service provider can have benefit either under Notification 12/2003-ST or 1/2006-ST and not both.*

This method is not available in case the service provider provides only completion and finishing services (as in such cases, material content will be much less).

This method is also not applicable if service is covered under 'works contract service'.

6.1 Charges some common services like park, common sewerage and effluent treatment, internal roads, common recreation hall etc.

Definition of residential complex covers these elements. Further, in the Budget 2010, a service termed as 'preferential location or development of complex' has been introduced w.e.f. 1-7-2010. The definition covers both commercial and residential complex. Thus, value of these amenities would get covered under that head (on *pro rata* basis), even if these are excluded from 'construction service'.

6.2 Increase in prices as construction is nearing completion

As the construction is nearing completion, the value of flat/commercial unit/shop goes up substantially.

Really, even if value (selling price) goes up, that does not mean that cost of construction has gone

up to that extent. The value goes up because of demand/supply situation and customer is willing to pay higher price when there is ready possession or construction is nearing completion.

In such cases, payment of service tax only on value of service will result in substantial reduction of service tax liability, instead of going in for composition scheme. Hence, it is advisable to calculate value of service and pay service tax on that @ 10.30%.

This can also be justified from the fact that 'preferential location and development of complex' has been specified as a different taxable service. Thus, any charge over and above value of construction service cannot be subjected to tax.

6.3 Valuation when a builder/developer has agreed to provide some flats/shops free of cost to the landowner

Really, the flats/shops are not given free to landowner but are *in lieu of* land cost. In such case, value of service will have to be found out on basis of value of service of identical or similar flat/shop or on basis of cost of construction plus reasonable profit.

Two methods are available – (a) Value of similar service (b) If value of similar service is not available, then cost plus reasonable profit [Rule 3 of Service Tax Valuation Rules].

Valuation can be on basis of value of similar service or on cost plus reasonable profit, as provided in Rule 3 of Service Tax Valuation Rules.

6.4 Choice of method of valuation

The 25%/33% scheme is simple but the liability of service tax will be high, particularly at places where land costs are very high. Further, if you are getting the work done through contractors/sub-contractors, you cannot take Cenvat credit of service tax paid by contractor/sub-contractor. This will further add to the cost.

Hence, in such cases, it is advisable to pay service tax on value of services @ 10.30%.

Value of services can be calculated either on cost plus profit basis or by reducing value of land and material from the total contract value.

If the contract is small, 25%/33% scheme may be opted since it is simple.

Each contract can be treated as separate contract and valued differently.

7 Cenvat Credit

Builder/developer can get and utilise Cenvat credit of all the input services and capital goods only if he is paying service tax on the value of services @ 10.30%. If the builder is paying service tax under simplified scheme on 25%/33% of total value, he cannot avail any Cenvat credit at all.

If service provider is providing both taxable and exempt service, then it is advisable to avail Cenvat credit only in respect of input services directly attributable to taxable services. If Cenvat credit is availed of common input services, then rigors of proportionate reversal or payment of 6% 'amount' on exempted services, as contained in rule 6 will apply.

8 Preferential location and development of complex service

As per section 65(105)(zzzzu) of Finance Act, 1994 (inserted w.e.f. 1-7-2010), any service provided or to be provided, to a buyer, by a builder of a residential complex, or a commercial complex, or any other person authorised by such builder, for providing preferential location or development of such complex but does not include services covered under sub-clauses (zzg), (zzq), (zzzh) and in relation to parking place, is a 'taxable service'. *Explanation.*— For the purposes of this sub-clause, "preferential location" means any location having extra advantage which attracts extra payment over and above the basic sale price.

On these services, tax is payable at full rate of 10.30% without any abatement.

CBE&C, has clarified as follows – (Annexure- A to JS (TRU-II) D.O. letter F No.334/1/2010-TRU dated 26-2-2010)

It has been reported that in addition to these activities, the builders of residential or commercial complexes provide other facilities and charge separately for them and these charges do not form part of the taxable value for charging tax on construction. These facilities include, - (a) prime/preferential location charges for allotting a flat/commercial space according to the choice of the buyer (i.e. Direction- sea facing, park facing, corner flat; Floor- first floor, top floor, Vastu- having the

bed room in a particular direction; Number- lucky numbers); (b) internal or external development charges which are collected for developing/maintaining parks, laying of sewerage and water pipelines, providing access roads and common lighting etc; (c) fire-fighting installation charges; and (d) power back up charges etc.

Since these charges are in the nature of service provided by the builder to the buyer of the property over and above the construction service, such charges are being brought under the new service. Charges for providing parking space have been specifically excluded from the scope of this service. Development charges, to the extent they are paid to State Government or local bodies, will be excluded from the taxable value levy. Further, any service provided by Resident Welfare Associations or Cooperative Group Housing Societies consisting of residents/owners as their members would not be taxable under this service.

9 Constitutional Validity of the levy

The provision of 'deemed service' has been challenged in various High Courts. Some High Courts have granted stay to the imposition of tax. In *Maharashtra Chamber of Housing Industry v. UOI 2010-TIOL-526* [Writ Petition No. 1456 of 2010], Hon. Mumbai High Court has granted stay on 3-7-2010 for coercive action for recovery of service tax on residential complex. However, it has been clarified that assessment of tax can continue. Similar order has been passed in writ petitions filed by *DB Realty Ltd., Mighty Construction and Mayfair Housing*. [Thus, stay is limited only for coercive action for recovery. Hence, not much can be read into the stay order, as assessment can continue,

which means assessee has to register with service tax],

Tax on lands and buildings is covered in List II (State List) of Seventh Schedule to Constitution of India. The argument is that the tax on buildings can be imposed only by State Government. Really, the service tax is not directly on building but on construction of the building.

In *Association of Leasing and Financial Services v. UOI (2010) 7 taxmann.com 740 = 35 VST 549* (SC 3 member bench), the levy has been indirectly upheld (though the issue in this judgment was in respect of service tax on leasing).

Hence, most probably, the provision in respect of deemed service is likely to be finally upheld.

10 Conclusion

Whatever stated above is on present understanding of the law. It is possible that some of the views may not be accepted by department.

Hence, a builder/developer has to take policy decision on basis of his final conclusions. In service tax, full disclosure is key to safety. Thus, wherever in doubt, assessee should inform to department his view, his understanding and what he are going to do by writing a letter. Asking clarification is not generally advisable.

Full disclosure to department has following advantages – (a) Penalty cannot be imposed and (b) Demand beyond one year is not sustainable. However, interest @ 13% is mandatory if by chance your understanding is not accepted by Tribunal or High Court or Supreme Court.

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Towards understanding issues in Convergence to IFRS

M. Subramanyam



Introduction:

The issue of Convergence with International Financial Reporting Standards (IFRS) has been gaining considerable momentum in India after the announcement by the Institute of Chartered Accountants of India (ICAI) to converge with IFRS with effect from 01.04.2011 by all listed and public interest entities such as banks, insurance entities and large sized entities in the first phase. IFRS has recently emerged as the primary accounting framework, with widespread global acceptance (IFRS: Developing a Roadmap to Convergence, March 2008 by KPMG in India). There are now more than 100 countries across the world where IFRS is either required or permitted. Converging with IFRS will bring almost the entire world on one single uniform accounting platform with good number of attendant benefits to large number of entities for doing global business. Moving from Indian GAAP to IFRS is not merely changing from one set of accounting policies to another. It is much more, since it not only has significant accounting consequences but also far reaching business implications. Some of the major areas impacted due to convergence with IFRS will be:

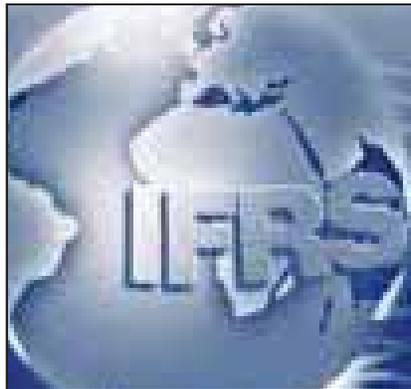
- Business Combinations
- Group Accounts
- Fixed Assets and Investment Property
- Presentation of Financial Statements

Experts are of the opinion that there will be major impact on the profitability and the way in which business management is looked at by various stakeholders due to the convergence to IFRS. Also it is expected that there will be deviations in the

way major leveraging ratios are calculated after the convergence with IFRS.

Convergence to IFRS in India:

On 22nd January 2010, the Ministry of Corporate Affairs had issued a press release setting out the



“Roadmap for Convergence with IFRS” for certain defined entities w.e.f. accounting periods commencing on or after April 1, 2011. The globalization of the business world and the attendant structures and the regulations, which support it, as well as the development of e-commerce makes it imperative to have a single globally accepted financial reporting system. Increasing complexity of business

transactions and globalization of capital markets call for a single set of high quality accounting standards. High standards of financial reporting underpin the trust investors place in financial and non-financial information. Thus, the case for a single set of globally accepted accounting standards has prompted many countries, including India to pursue convergence of national accounting standards with IFRS.

As evidenced by the global experience, convergence with IFRS would also pose significant challenges for corporate India. Additionally, there are certain specific challenges that are unique to India. Unlike in several other countries, the accounting framework in India will depend on co-operation received by the ICAI from the Government, Regulators – Reserve Bank of India (RBI), Securities Exchange Board of India (SEBI)

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and Insurance Regulatory and Development Authority (IRDA), Tax authorities, Courts and Tribunals. For example, the central government will have to prescribe IFRS as accounting standards under Section 211 of the Companies Act 1956. Regulators - SEBI, RBI and IRDA would need to accept IFRS in substitution of the present set of specific accounting rules prescribed by them. Corresponding amendments in taxation laws may also be required (for example, tax treatment of unrealized gains due to fair value measurements).

Ministry of Corporate Affairs had set up a High Powered group comprising various stakeholders to identify changes required in various laws, regulations and accounting standards for convergence with IFRS.

The committee decided to address the issues on various implementation challenges, especially those related to legal and accounting framework and transitional issues. Further, sector specific challenges especially in the banking, insurance, shipping, small & medium enterprises were also discussed. The ICAI presented the details of a comprehensive capacity building programme which the Institute is carrying on to prepare the CA profession for this transition and stated that a large number of professionals have undergone training and the process is being accelerated. The Chairman of the Accounting Standards Board of ICAI placed on record that the convergence project is at an advanced stage of completion. CFOs present in the meeting stated that industry was getting prepared though there were some concerns from smaller companies. They also requested amendments to the Companies Act and other Regulations and also the early exposure of accounting standards which are IFRS compliant, to enable them to prepare for meeting the deadline.

The following areas, where significant accounting changes are anticipated are discussed below:

Business Combinations:

IFRS 3 (Revised) requires the net assets taken over, including contingent liabilities and intangible

assets to be recorded at fair value, unlike Indian GAAP, which requires, (in the case of subsidiaries, associates and joint ventures) the recording of net assets at carrying cost. Contingent liabilities of the acquiree are not recorded as liabilities under Indian GAAP. Likewise, there are differences in treatment of amortization of goodwill, reverse acquisitions (Indian GAAP does not deal with reverse acquisitions), measurement of contingent consideration in a business combination and other areas. The changes brought in by IFRS 3 (Revised) will affect all stages of the acquisition process, from planning to the presentation of the post deal results. The implications primarily involve providing greater transparency and insight into what has been acquired, and allowing the market to evaluate the management's explanations of the rationale behind a transaction.

The world has always been the same; and there has always been as much good fortune as bad in it.

Group Accounts:

There are many key differences with regard to the accounting for Group Accounts under IFRS. Under IAS 27 (Revised), Consolidated and Separate Financial Statements, the preparation of group accounts is mandatory, subject to a few exemptions, whereas, preparation of Consolidated Financial Statements (CFS) is required only for listed entities under Indian GAAP. Also, the application of equity method or proportionate consolidation to associates/joint ventures is mandatory under IAS 27 (Revised) whereas preparation of financial statements (CFS) is required only for listed entities under Indian GAAP. The application of equity method or proportionate consolidation to associates/joint ventures is mandatory, subject to a few exceptions, even if an entity does not have any subsidiaries as per IAS 27 (Revised). Under Indian GAAP, application of the equity method or proportionate consolidation is required only when the entity has subsidiaries and prepares CFS. Under IAS 27 (Revised), consolidation is required for all subsidiaries, whereas, there are two exemptions from consolidation provided under Indian GAAP. Potential Voting Rights, which are currently exercisable, are considered for determination of control under IFRS; Indian GAAP

is silent on whether potential voting rights are to be considered for control. However, under AS 23, potential voting rights are not considered for determining significant influence in the case of an associate. Thus, an analogy can be drawn in the case of a subsidiary as well. Both, IFRS and Indian GAAP require use of uniform accounting policies for preparation of CFS. However, Indian GAAP provides an exemption on the grounds of impracticality.

IFRS allows a 3 month's time gap between financial statements of a parent or investor and its subsidiary, associate or jointly controlled entity. Indian GAAP allows a 6 months time gap for subsidiaries and jointly controlled entities. For associates, there is no time gap prescribed. Under IFRS, changes in ownership interest of a subsidiary (that do not result in the loss of control) are accounted for as an equity transaction and have no impact on goodwill or the income statement. No guidance is given in Indian GAAP for changes in ownership interest of subsidiary that do not result in loss of control. IFRS requires losses incurred by the subsidiary to be allocated between the controlling (parent) and non-controlling equity investment in the subsidiary. Under Indian GAAP, excess losses attributable to minority shareholders over the minority interest are adjusted against the majority interest unless, the minority has a binding obligation to, and is able to, make good the losses.

Fixed Assets and Investment Property:

As per the provisions contained in IAS 16, Property, Plant and Equipment mandates component accounting, whereas, AS 10 recommends, but does not require, component accounting. IFRS requires depreciation to be based on the useful economic life of an asset. In Indian GAAP, depreciation is based on higher of useful life or Schedule XIV rates. Major repairs and overhaul expenditure are capitalized under IFRS as replacement costs, if they satisfy the recognition criteria, whereas, in most cases, Indian GAAP requires these to be charged off to the profit and loss account as incurred. IFRS requires estimates of useful lives and residual values to be reviewed at least at each financial year-end. In Indian GAAP, there is no need for an annual review of estimates of useful lives and residual values.

Both IFRS and Indian GAAP permit the revaluation model for subsequent measurement. If an asset is

revalued, IFRS mandates revaluation to be done for the entire class of property, plant and equipment to which that asset belongs, and the revaluation to be updated periodically. In Indian GAAP, revaluation is not required for all the assets of the given class. It is sufficient that the selection of the assets to be revalued is made on systematic basis, e.g., an entity may revalue a class of assets of one unit and ignore the same class of assets at other location. Also, there is no need to update revaluation regularly under Indian GAAP.

Under IFRS, depreciation on the revaluation portion cannot be recouped out of revaluation reserve and will have to be charged to the income statement over the useful life of the asset, whereas, Indian GAAP permits depreciation on revaluation portion to be recouped out of revaluation reserve to the income statement.

IFRS provides detailed rules for classification of an asset as an investment property and allows subsequent measurement of investment property at cost or at fair value. Indian GAAP requires investment property to be recognized at cost less diminutions other than temporary diminutions in value.

Under IFRS, intangible assets can have indefinite useful life. Such assets are required to be tested for impairment and are not amortized. Under Indian GAAP, there is no concept of indefinite useful life.

Presentation of Financial Statements:

IAS 1 (Revised 2007) Presentation of Financial Statements (effective from annual accounting periods beginning on or after 1st January 2009) is significantly different from the corresponding AS-1. While IAS 1(R) sets out overall requirements for the presentation of financial statements, guidelines for their structure and minimum requirements for their content, Indian GAAP offers no standard outlining overall requirements for presentation of financial statements. In India, for various entities, the statutes governing the respective entities lay down formats of financial statements. For example, in the case of companies, format and disclosure requirements are set out under Schedule VI to the Companies Act, 1956. For entities such as partnership firms, the statute

governing those entities does not lay down any specific format of financial statements. IAS 1(R) recognizes the true and fair override provisions. The true and fair override concept is generally not permitted under Indian GAAP. While Clause 49 of the Listing Agreement contains provisions relating to the true and fair override, no practical guidance is available. Further IAS 1(R) requires the presentation of a statement of comprehensive income as part of the financial statements. This statement presents all items of income and expense recognized in profit or loss, together with all other items of recognized income and expense. Entities may either present all items together in a single statement or present two linked statements displaying the items of income and expense recognized in profit or loss (the income statement), and statement beginning with profit or loss and displaying all the items included in 'other comprehensive income' (the statement of comprehensive income). The concept of 'other comprehensive income' does not prevail under Indian GAAP, however, information relating to movement in reserves, etc., is generally presented in the caption reserves and surplus in the balance sheet.

Discussion:

Addressing sensitivity to local conditions:

The issue of convergence with IFRS has gained considerable momentum in India. At present, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) formulates Accounting Standards based on IFRS. However, these standards remain sensitive to local conditions, including the legal and economic environment. Accordingly, the Accounting Standards issued by the ICAI depart from the corresponding IFRS in order to ensure consistency with the legal, regulatory and economic environments of India.

Application of Fair Value concept:

Further, the IFRS are principle-based standards and the application requires the increased use of Fair Value Accounting (FVA) for valuation and measurement of assets and liabilities. Fair Value is defined as "An estimate of the price an entity would have realized if it had sold an asset or paid if it

had been relieved of a liability on the reporting date in an arm's length exchange motivated by normal business considerations." Evidence shows that FVA would result in added volatility in the earnings and equity, especially for the banking and financial institutions. Possible reason for many countries to delay adopting to the IFRS is attributed to the economic downslides being faced by them of late, mainly in the US and other European countries, where there is formidable opposition to the adoption of fair value concept, apprehension being that, applying fair value to their assets and liabilities may result in triggering the contagion effect.

Legislative Changes:

Important issue for detailed discussion is the one relating to the bringing in suitable legislative changes required to various laws - compliance to which is mandatory for all the entities whether in the public, government or private domain. For example, the format of reporting financial statements is as per the guidelines provided by IASB. IAS 1 requires presentment of the financial position in a flowing format. This is significantly different from the provisions contained in Schedule VI of the Companies Act 1956 for public and private limited companies and as per the Banking Regulations Act for Banking and Insurance entities. Suitable amendments needs to be brought in to these legal enactments enabling entities converging to IFRS to present the financial statements as prescribed. Likewise there are many areas, as discussed in the earlier paragraphs which require amendment to laws with legislative sanctions.

Conclusion:

The timeline for convergence of India's GAAP with IFRS is April 1, 2011. Companies started adopting the standards from Financial Year 2010 itself so that comparative figures would be available for disclosure in the annual report. A successful transition requires a well-thought of plan and hopefully well in advance. Good number of entities, which have been doing global business already, are reported to have readied themselves by preparing their organizations to meet the challenges head-on and without much ado.

Exchange Traded Funds

Lokesh Gupta



Exchange-traded funds (ETFs) can be a valuable component for any investor's portfolio. Some investors have sole focus of their portfolios on ETFs and are able to build a well-diversified portfolio with just a few ETFs. Others use ETFs to complement their existing portfolios, and rely on ETFs to implement sophisticated investment strategies. But investors cannot benefit from ETFs unless they understand and use them appropriately.

An ETF represents shares of ownership of a unit investment trust (UIT), which holds portfolios of stocks, bonds, currencies or commodities. It trades like a stock on a stock exchange and looks like a mutual fund. Its performance tracks an underlying index, which it is designed to replicate. The first U.S. ETFs were the S&P 500 depository receipts; also known as SPDRs ("spiders") that tended to track broad market indexes. Here more recent ETFs have been developed to track sectors, fixed income, global investments, commodities and currencies.

ETFs are often compared to mutual funds. Like a mutual fund, an ETF is an investment structure that pools the assets of its investors and uses professional managers to invest the money to meet clearly identified objectives, such as current income or capital appreciation. And, like a mutual fund, it also has a prospectus. An ETF delivers a prospectus to the retail purchaser or provides investors a document known as a product description, which summarizes key information about the ETF. A mutual fund investor purchases or redeems directly from the fund, at the mutual fund's net asset value (NAV) at the end of each trading day, while who buys an ETF purchases the shares on a stock exchange in a process identical to the purchase or sale of any other listed stock. Although most mutual funds are actively managed,

a significant number of index funds are available. Although most ETFs are passively managed - designed to track specific indexes - a few actively managed ETFs have been introduced.

Creation

Creating an ETF first requires a fund manager to submit a detailed plan to the regulatory authority.

The plan describes a set of procedures and the composition of the ETF. Typically, only the largest money management firms, with experience in indexing, can create and manage ETFs. These firms are in touch with major investors, pension funds and money managers throughout the world, which have the pool of stocks required for ETF creation. The creation of an ETF officially begins with an authorized participant, also referred to as a market maker

or specialist. These are middlemen who assemble the appropriate basket of stocks. The basket of shares is sent to a designated custodian bank, which in turn forwards the ETF shares to the market maker for safekeeping. The minimum basket size is called a creation unit.

Redemption

To redeem the shares, an authorized participant buys a large block of ETFs, forwards them to the custodian bank and receives an equivalent basket of individual stocks. These stocks can then be sold on a stock exchange although they are usually returned to the institution that loaned the shares. An investor can dispose off an ETF in two ways - either redeem it by submitting the shares to the ETF fund in exchange for the underlying shares, or sell it on the secondary market.

Features

The vast majority of ETFs are designed to track an

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The value of life lies not in the length of days, but in the use we make of them; a man may live long yet live very little.

index, so their performance is close to that of an index mutual fund. The difference between the returns of a fund and the returns of the index can arise due to differences in composition, management fees, expenses and handling of dividends. Anyone can buy any ETF no matter where in the world it trades. Buying and selling ETFs can be good for the small investor as ETFs enjoy continuous pricing; they can be bought and sold on a stock exchange throughout the trading day. Because they trade like stocks, one can place orders just like with individual stocks - such as stop loss orders, limit orders, good-until-cancelled orders etc. They can also be sold short. They are bought and sold at the market prices on the exchanges, which resemble the underlying NAV but are independent of it. However, arbitrageurs will ensure that ETF prices are kept very close to the NAV of the underlying securities.

Arbitrage

When the ETF price starts to deviate from the underlying NAV of the component stocks, participants can step in and take profit on the differences. If the ETF shares are trading at a price lower than the NAV of underlying securities, then arbitrageurs will buy ETF shares on the open market. The arbitrageurs will then form creation units, redeem the creation units to the custodian bank, receive the underlying securities and sell them for a profit. In the opposite case, arbitrageurs will buy the underlying securities on the open market, redeem them for creation units, and then sell the ETF shares for a profit.

Active versus Passive Investing

Although indexing (a passive investment strategy) has been used by institutional investors for many years, it is still relatively new for the typical individual investor. Because ETFs use predominantly passive strategies, the first question any investor should consider is whether to take an active or passive approach to investing.

Active Investing

This investment strategy attempts to outperform the market, or say, to beat the particular benchmark. The majority of mutual funds are actively managed. Analyzing market trends, the economy and the company-specific factors, active managers are constantly searching out information and gathering insights to help them make their investment decisions. There are almost as many methods of active management as there are active managers including fundamental analysis, technical analysis, quantitative analysis and

macroeconomic analysis. Active managers believe that because the markets are inefficient, anomalies and irregularities in the capital markets can be exploited by those with skill and insight.

Passive Investing

This investment management approach is based on investing in exactly the same securities and in the same proportions as an index. It is called passive because portfolio managers don't make decisions about which securities to buy and sell; they merely follow the same methodology of constructing a portfolio as the index uses. The managers' goal is to replicate the performance of an index as closely as possible. Passive managers invest in broad sectors of the market, called asset classes or indexes, and are willing to accept the average returns various asset classes produce. Passive investors believe in the efficient market hypothesis (EMH), which states that market prices are always fair and quickly reflective of information. EMH followers believe that consistently outperforming the market for the professional and small investor alike is difficult. Therefore, passive managers do not try to beat the market, but only to match its performance.

If a passive approach is desired, an investor should then consider how best to implement it - by using index funds or exchange traded funds.

Index Funds versus ETFs

Although the number of index funds and ETFs are close, ETFs cover about five times as many indexes. Some of the newer ETFs track some indexes that are more appropriate for an ETF structure than for an index fund. Consequently, an investor might only be able to track an index by using ETFs because there are no index funds available that can track that same index. The following are the main differences between Index Funds and ETFs:-

Costs

ETFs and index funds each offer advantages and disadvantages for managing the costs of the underlying assets. In some cases, the difference in fees might favour one over the other. Investors can buy no-load index funds without incurring any transaction costs while investors buying ETFs will have to pay brokerage commissions.

Tax Efficiency

In nearly all cases, the structure of an ETF results in lower taxes versus the equivalent index fund. This is because the way in which ETFs are created and redeemed eliminates the need to sell securities. With index funds, securities are bought and sold, although with lower turnover than a typical

actively managed fund. These transactions will trigger capital gains that have to be distributed to the unit holders.

Dividends

ETFs accumulate dividends or interest received from the underlying securities until it is distributed to shareholders at the end of each quarter. Index funds invest their dividends or interest income immediately.

Rebalancing

An investor with a portfolio of index funds or ETFs occasionally rebalances the portfolio, selling some of the positions and purchasing others. A portfolio containing ETFs incurs commissions by buying and selling the ETFs. Because the investor typically trades in board lots, getting the exact weightings of each ETF desired is practically impossible. This is especially true for small portfolios. With index funds, an investor can achieve exact asset allocation weightings because the investor can purchase fractional units.

ETF Investment Strategies

ETFs provide considerable flexibility in implementing various investment strategies. Strategies range from very simple, such as diversifying an existing portfolio, to sophisticated hedging strategies.

Core Holding

An investor can consider using a few ETFs as core portfolio holdings. A low-cost diversified portfolio can easily be constructed with a few ETFs to cover the major equity asset classes and the fixed-income market. From that starting point, the investor can customize a portfolio with additional securities, mutual funds or other ETFs.

Asset Allocation

An investor can take a passive approach to asset allocation by rebalancing the portfolio only to ensure it returns back to the long-term or strategic asset mix. Alternatively, the investor can take an active role in asset allocation, by tactically rebalancing the portfolio, overweighting those asset classes that are expected to outperform in the shorter term and underweighting the others.

Diversification

ETFs allow the investor not only to diversify across all the major asset classes, such as U.S. equity, foreign equity and fixed income, but also to diversify into investments that have a low correlation to the major asset classes. This includes areas like commodities, real estate, emerging markets, small cap stocks and others.

Hedging

Investors who want to hedge against a drop in the market can purchase inverse ETFs or leveraged inverse ETFs, which rise when the market falls. An investor concerned about inflation can hedge it by investing in commodities or inflation-protected bond ETFs. Of course, investors can short an appropriate ETF that can hedge against a very specific stock market exposure. Many ETFs have options that can be used for other hedging strategies, either separately or in conjunction with the underlying ETF.

Cash Management

ETFs can be used to “equitize” cash, allowing investors an easy way to put their money in the stock market until a long-term investment decision is made. In this way, investors can ensure they do not miss out on price rises or forego income while their money is parked temporarily.

Tax-Loss Harvesting

Tax-loss harvesting is a strategy of realizing capital losses in a taxable account, and then redeploying the sale proceeds among similar investments, leaving the investor’s portfolio largely unchanged. The wash-sale rule prevents an investor from selling a security at a loss and then immediately repurchasing it, by disallowing the purchase of “substantially identical” securities within 30 days of a sale. With the availability of a wide variety of ETFs, buying an ETF that is very similar to the fund or stock being sold is easy.

Completion Strategies

An investor might want to quickly gain exposure to specific sectors, styles or asset classes without having to obtain the prerequisite expertise in these areas. Using ETFs allows an investor to easily fill the “holes” in his portfolio.

Portfolio Transitions

Many investors move portfolio assets between different advisors, managers or funds. In the transition period, the assets might be allowed to sit idle in cash. ETFs allow investors to keep their assets invested rather than having them dormant.

Conclusion

An investor who wants to buy ETFs has a myriad of options to choose from in equities, foreign stocks, fixed income and alternative investment. There are also many different strategies the investor can employ when using ETFs. Like other investments, it is important for the investor to evaluate the different options to ensure the right ETF is chosen for the job.

Relearning the Learning Curve

Pavan Pal Sharma

It is a common fact that one gets better at doing something if he does the same work repeatedly. This is as much relevant in a factory that produces an article as it is in real life. The efficiency of performing a task increases as the worker continuously performs the same task.

Here is where the concept of learning curve comes into play.

The theory of learning curve is based on the simple tenet that, "as a man gains experience through the repeated performance of the task, the time required by him to perform every subsequent similar task falls".

In a complex organization structure, like that of a production centre, this cannot be solely attributed to the increase in the labour productivity. The reduction in the costs¹ can be also attributed to

- Better control of the production process
- Redesign of the product
- Standardization
- Utilization of inputs in efficient manner, etc.

So we can say that the costs [where cost = $f(\text{time})$] would generally fall as the concept of 'gaining experience' comes into play.

Let the time to perform a task be 't' and the cost per hour be 'c'.

We can say then that the total time related cost 'T', would be

$$T = [t.c]$$

Say the task is performed as below

Times performed per hour	Average time	Cost per hour	Total costs
1 time	t	c	T = [t.c]
2 times	t	c	T = [2t.c]
3 times	t	c	T = [3t.c]
n times	t	c	T = [nt.c]

When the concept of experience is brought into picture, then the same data can be presented as below

Times performed per hour	Average time	Cost per hour	Total costs
1 time	t_1	c	T = [$t_1.c$]
2 times	t_2	c	T = [$2t_2.c$]
3 times	t_3	c	T = [$3t_3.c$]
n times	t_n	c	T = [$nt_n.c$]

Where;

t_i (i = 1 to n) = Time in hours

c = Cost per hour,

T = Total cost, and

$$t_n < t_{(n-1)} < \dots < t_3 < t_2 < t_1$$

We can draw two inferences from the above data

- Average time required for the performance of every immediate process falls.
- The total time/cost increases, but it increases at a decreasing rate.

Wright's Cumulative Average Model [WCAM]

The concept of learning curve/experience curve was first developed in 1936 by Theodore Paul Wright. It was applied in the airline industry. It was observed that whenever the output was doubled, the time required for production on an average fell.

WCAM suggests that the average time required to double the output would fall by a constant, say K, when compared to the time required for the immediately preceding batch. The symbol, 'K' here represents the learning co-efficient expressed in percentage terms².

¹ Such costs are a function of time. Labour costs are the best example of costs that can be expressed as a function of time.

² The rate of improvement and learning percentage are complementary to each other. We can say that Learning % = 1 - Improvement %.

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The equation of WCAM is as below

$$Y = a.X^s$$

Where;

1. Y = Average time/cost of X units
2. a = Time/cost required for the first unit
3. X = Sequential number of the last unit in the quantity for which the average time/cost is intended to be computed
4. s = Parameter of the equation.

Let us look into the derivation of WCAM.

We know that,

$$Y_n = a. X^s$$

If the production volume is double then we will have,

$$Y_{2n} = a. (2X)^s$$

The relationship between Y_n and Y_{2n} is

$$Y_{2n} = b. Y_n$$

Where, 'b' is a factor by which time/cost is reduced when the price is doubled. 'b' is related to s in the following manner.

$$b = 2^s$$

or

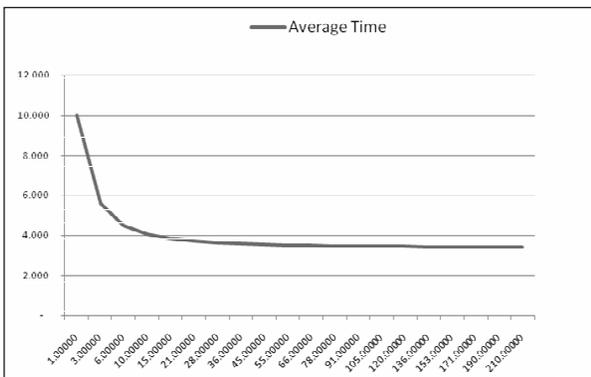
$$s = \log_2 b$$

So we can say,

$$Y_n = a. X^{\log_2 b}$$

The above formula is frequently used to solve learning curve problems.

When we plot the curve Y_n using Production on X-axis and average time/cost on the Y-axis we get the following curve³.



³ The curve has been plotted using hypothetical data taking learning co-efficient b to be 34%.

⁴ The CIUM has not been dealt with in detail in this discussion paper. Only the formula has been depicted.

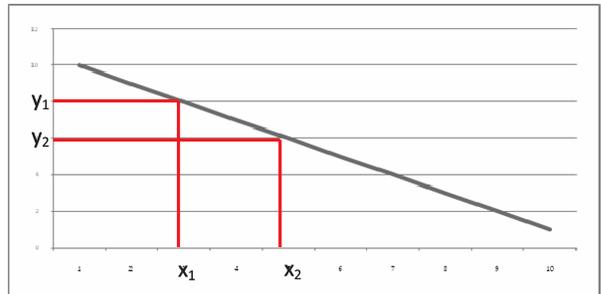
The equation of Y_n can also be expressed in a logarithmic form

$$\text{Log } Y_n = \text{Log } a + s. \text{Log } X$$

The above equation is in the standard form of,

$$y = c + m.x$$

So we can say that when the learning curve is expressed in the form of logarithms it would be a straight line.



We know that the slope of a line can be expressed as

$$m = \frac{y_2 - y_1}{x_2 - x_1}$$

In the above case, the slope of the curve is always negative. [as $y_2 > y_1$]. Also, by the logarithmic equation given above, we can draw an inference as to the nature of the slope. The slope of the above line is 's'. Where $s = \text{Log}_2 b$. 'b' is the learning coefficient, that is generally expressed in the form of a percentage. The Log value of a decimal is negative. The slope is hence negative.

Crawford's Incremental Unit time Model [CIUM]⁴

Crawford interpreted the basic learning curve formula in a different way and gave us the CIUM. The equation for the same is discussed below:

$$Y = a.K^s$$

Where;

1. Y = Average time/cost of X units
2. a = Time/cost required for the first unit
3. K = Algebraic midpoint of specific production
4. s = Parameter of the equation.

The algebraic midpoint of the equation K can be arrived as below:

$$K = \left\{ \frac{L(1+s)}{N_2^{(1+s)} - N_1^{(1+s)}} \right\}^{1/s}$$

Other Important points

1. Relationship between learning ratio and improvement ratio.

As stated in footnote 2, learning ratio and improvement ratio are complementary to one another. The two add up to unity (when expressed as decimals) or 100 (when expressed in percentage)

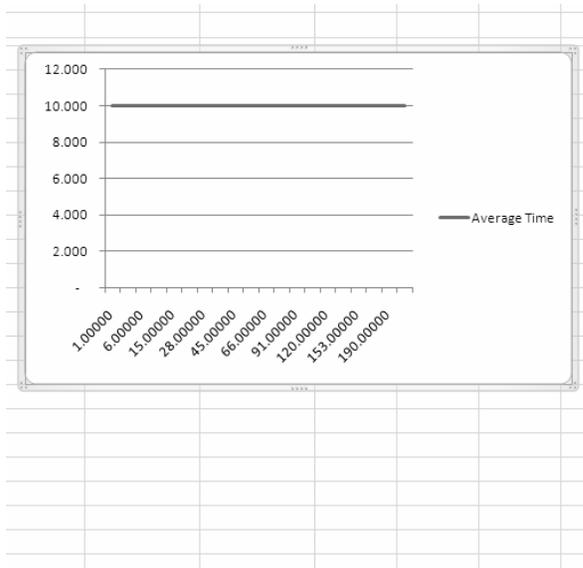
It can be said that when a process improves by x%, the learning co-efficient for such a process is (1-x) %

It can also be said that, when a process improves by x%, the cost/time shall reduce by x%. It can also be said that the cost/time will fall to (1-x) %.

2. When b = 100% (or learning co-efficient is 100%)

In such a case it is observed that the cost/time will not reduce by any amount (Improvement ratio = 0!). The learning curve here would be a straight line parallel to the X-axis.

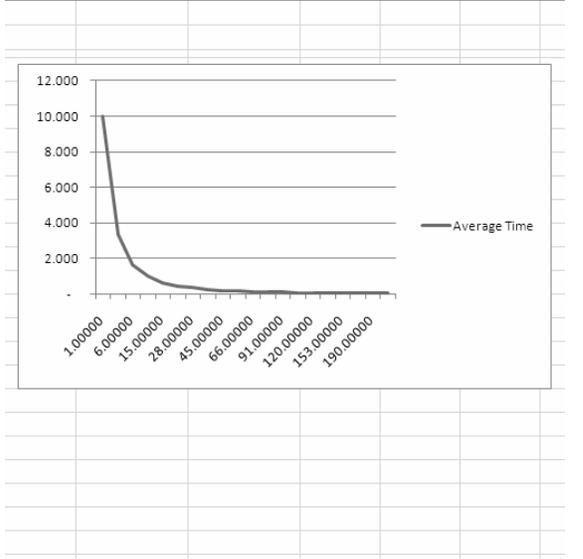
Learning Ratio		1,0000		
Output	Cum Output	Total Time	Cum Time	Average Time
1.00000	1.00000	10.00000	10.000	10.000
2.00000	3.00000	20.00000	30.000	10.000
3.00000	6.00000	30.00000	60.000	10.000
4.00000	10.00000	40.00000	100.000	10.000
5.00000	15.00000	50.00000	150.000	10.000
6.00000	21.00000	60.00000	210.000	10.000
7.00000	28.00000	70.00000	280.000	10.000
8.00000	36.00000	80.00000	360.000	10.000
9.00000	45.00000	90.00000	450.000	10.000
10.00000	55.00000	100.00000	550.000	10.000
11.00000	66.00000	110.00000	660.000	10.000
12.00000	78.00000	120.00000	780.000	10.000
13.00000	91.00000	130.00000	910.000	10.000
14.00000	105.00000	140.00000	1,050.000	10.000
15.00000	120.00000	150.00000	1,200.000	10.000
16.00000	136.00000	160.00000	1,360.000	10.000
17.00000	153.00000	170.00000	1,530.000	10.000
18.00000	171.00000	180.00000	1,710.000	10.000
19.00000	190.00000	190.00000	1,900.000	10.000
20.00000	210.00000	200.00000	2,100.000	10.000



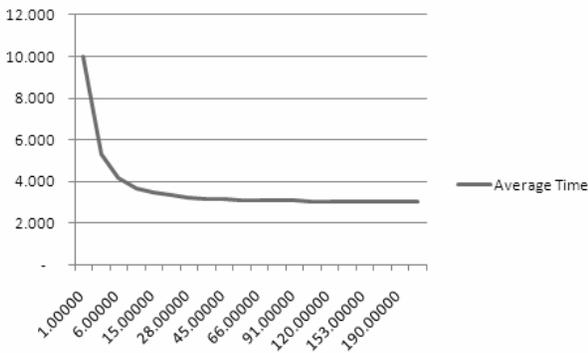
3. When b = 0% (or learning co-efficient is 0%)

In such a case we would observe that the learning curve dips drastically and conjoins the X-axis after a short interval. (Improvement ratio = 100!)

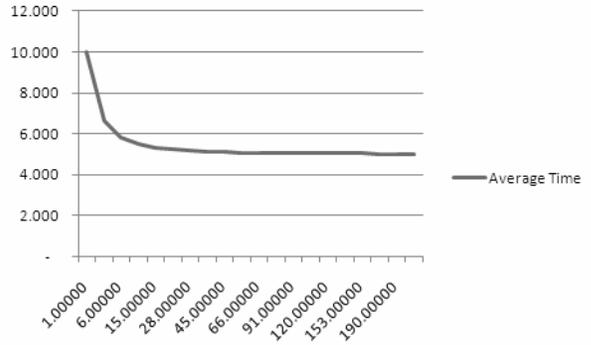
Learning Ratio		-		
Output	Cum Output	Total Time	Cum Time	Average Time
1.00000	1.00000	10.00000	10.000	10.000
2.00000	3.00000	-	10.000	3.333
3.00000	6.00000	-	10.000	1.667
4.00000	10.00000	-	10.000	1.000
5.00000	15.00000	-	10.000	0.667
6.00000	21.00000	-	10.000	0.476
7.00000	28.00000	-	10.000	0.357
8.00000	36.00000	-	10.000	0.278
9.00000	45.00000	-	10.000	0.222
10.00000	55.00000	-	10.000	0.182
11.00000	66.00000	-	10.000	0.152
12.00000	78.00000	-	10.000	0.128
13.00000	91.00000	-	10.000	0.110
14.00000	105.00000	-	10.000	0.095
15.00000	120.00000	-	10.000	0.083
16.00000	136.00000	-	10.000	0.074
17.00000	153.00000	-	10.000	0.065
18.00000	171.00000	-	10.000	0.058
19.00000	190.00000	-	10.000	0.053
20.00000	210.00000	-	10.000	0.048



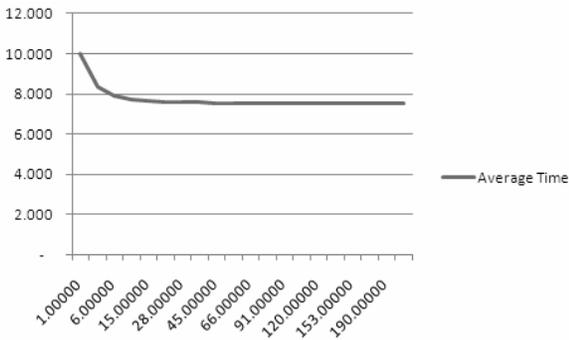
4. We have taken two rare and extreme cases of 100% and 0% above. Any value between this would result in the gradual upward movement of the curve until it becomes parallel to the X-axis. We can observe this below at 30%, 50%, 75%, 94%.



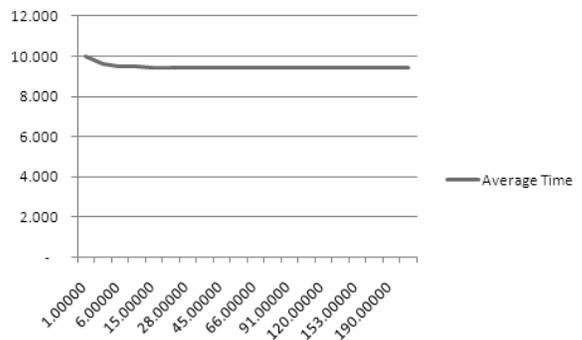
b = 0.30



b = 0.50



b = 0.75



b = 0.94

CROSSWORD

December-2010
Solution

	C	B	E	C		G	R	A	T	U	I	T	Y		
	O		M				T			G		I			
	A	X	I	S		B	I	T		C	P	M			
	S							P				I	R	R	
	T		W		F	L	O	O	R			N			
	A		R		I							C	G	H	S
	P	L	A	I	N	V	A	N	I	L	L	A			
	P			T		E		O		I		P	E	R	T
	P			E				S		F			X		E
			M	R	T	S		T		O	P	T	I	O	N
			A			I		R					M		
	S	T	T		E	X	P	O	R	T					

Current Happenings and Basic Insights into International Taxation

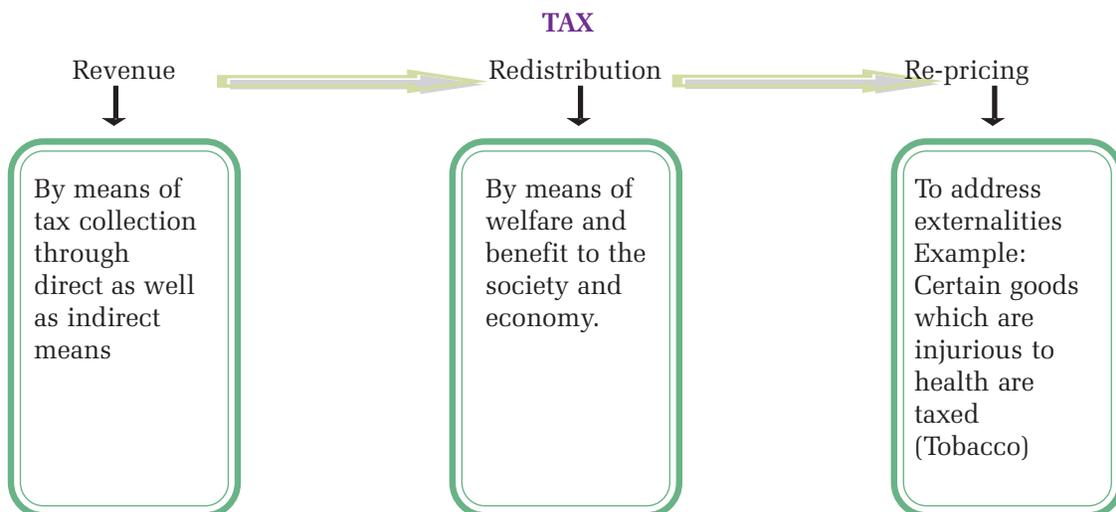
Karan Saraf



Introduction:

Broadly, the government collects taxes under two categories, direct sources and indirect sources. In direct sources, the incidence and impact is on the same person; indirect sources the incident and impacts are on two different persons. In today's industrialized world, the economic trends globally are based on individual and corporate taxation. Different economies across the globe have different taxation norms.

The Flow



International taxation trends:

Foreign direct investments as a part of globalization are on a rise. A lot of multinational investments largely are based on the tax norms. Henceforth a stable and industry supportive tax norms are the need of the day. Globally there has been a mixed trend noticed in the tax rates as some economies have increased tax rates to overcome deficit even during a recessionary trend and some, a fall in the tax rates. Tax regulators across globe are now in a greater sync with each other as corporations

are going global at a faster pace. This in turn has tethered the tax regulators with regards to issues involving such as double taxation, transfer pricing etc. **To have a sustainable business, corporations today have to ensure a global approach towards tax implications rather than a domestic approach.** The need for effective and attractive tax norms is equally important in all the 3 sectors of global economy i.e. Developed, Developing & Underdeveloped economies. Today regulators especially in

the developing nations are doing everything to maintain their competitive presence in the list of top emerging economies. **Today most economies rather than lowering the rates of personal income taxes, have switched over to a scene of stability or a marginal increase to overcome fiscal deficit and downturn effects.**

Certain facts and figures

Globally all economies have different tax norms and

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regimes. Some countries follow variable, some follow a flat tax rate policy and some even no tax policy. An analysis of the BRIC nations shows the following;

Brazil (2010)

PERSONAL TAXATION

MAXIMUM RATE AT 27.5% Tax year-end is 31 December

Flat rate of 15 percent generally applies to gains taxed under Brazil CGT.

CORPORATE TAXATION

The corporate income tax rate is 34 % (Basic tax@15% + surtax@10% on annual income of over BRL 240000+ 9% Social Contribution on net profits)

Russia (2010)

PERSONAL TAXATION

A flat tax rate of 13% Tax year end is 31st December

CORPORATE TAXATION

20% corporate tax split into federal 2% and regional 18% Dividend distribution tax is also applicable

India (2010)

PERSONAL TAXATION

The maximum marginal income tax rate on employment income is 30.90 percent including an education cess of 3 percent levied on tax.

Tax year-end is 31 March

CORPORATE TAXATION

Domestic companies are taxed at the rate of 30 percent.

Foreign companies are taxed at a rate of 40 percent.

A Minimum Alternate Tax (MAT) is leviable @18% of book profits if tax on total income is less than 18% of book profits. A 7.5% surcharge in case of domestic companies and a 2.5 percent surcharge in case of foreign companies, if total income exceeds ₹1 crore.

2010-11

NATION		Max.TAX rate
	SWEEDEN	56% (HIGHEST IN THE WORLD)
	JAPAN	50% (SECOND HIGHEST)
	UNITED KINGDOM	50%

China (2010)

PERSONAL TAXATION

**Highest slab of 45%.
Tax year-end is 31
December .**

CORPORATE TAXATION

There are three types of indirect taxes in China: value-added tax, consumption tax, and business tax. The rate of corporate income tax is 25 percent. The tax rate for a low profit enterprise is 20 percent and hi-tech enterprises are taxed at a rate of 15 percent if certain conditions are met.

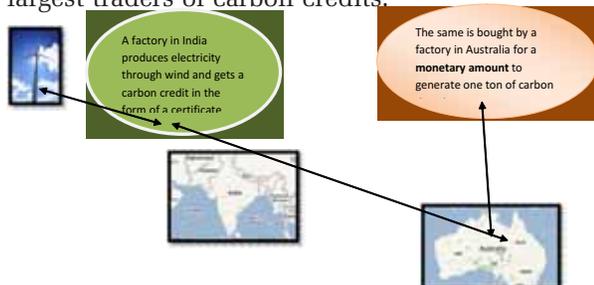
	UNITED STATES	35%
	KUWAIT	NO INCOME TAX
	UNITED ARAB EMIRATES	NO INCOME TAX
	CAYMAN ISLANDS	NO INCOME TAX

BRIC Nations Trend:

Though the world is looking BRIC nations on a collaborative basis from above we can find that each of the 4 nations have a varied and a distinct tax regime Russia being the only one to follow a flat tax regime (personal taxation) which has proved to be very stable and effective. China has the highest of personal tax rates amongst the four; however, China's corporate tax regime has proved to be attractive.

Taxation of carbon credits:

What is carbon credit? It is an initiative taken by countries around the world to have a sustainable planet. It is a tradable certificate or a permit to emit one tone of carbon dioxide. India is one of the largest traders of carbon credits.



Recent trends show increased efforts by the tax authorities to tax proceeds from carbon credits whose recognition criterion is met by AS 9 (treated as a commodity). CER sale is other income not Turnover. However taxation of the same may lead to efforts taken by the industries to "go green" slow. The view point of the tax authorities also cannot be ruled out henceforth an effort has to be taken to have sustainable taxation norms with respect to the same. There is estimated tax revenue of Rs 3000 crore arising out of carbon credit trade in India alone.

Transfer Pricing (TP):

One of the latest and happening issues in the world of international taxation is TP. Global organizations having a multi nation foot print often tend to reduce tax burden. It has been illustrated below.

Company X at USA (global Headquarters) of a MNC having presence across different economies.

Location "A" e.g. Cayman Island; a tax haven where company X has presence.

Company X in India may decide to import designs and patterns from Cayman Island where cost is much low, at a substantially higher price i.e. **more than the arms length price** say cost is Rs 10,00,000 CI may sell the same at Rs 20,00,000

Company X finds potential in location "B" say India where corporate tax rates are high. 30%. It has revenues worth ₹ 21, 00,000 and profit after expenses of 10, 00,000; tax on the same ₹3, 00,000. To save this tax company X may do the following

Cayman when sells the designs and patterns at a higher price derives more revenue in its books and however it is subject to no tax. When India purchases the same at a higher price its profit reduces and pays less tax. **Thus globally the profitability remains the same**

CASE 1

INDIAN OPERATIONS A/C

To R&D (design & patterns)	10,00,000	By revenues	21,00,000
To misc exp	1,00,000		
To profit	10,00,000		

SOLUTION

To overcome this problem tax authorities use the concept of transfer pricing wherein **Arms length price** is considered and any difference arising thereof is adjusted and claimed by the tax authorities

CASE 2

Cayman A/C

To R&D	10,00,000	By revenues	20,00,000
To profit	10,00,000	(designs, patterns)	

NIL TAX ON THE SAME

INDIAN OPERATIONS A/C

To R & D purchased	20,00,000	By revenues	21,00,000
To misc exp	1,00,000		
To profit	0		

Thus the Indian arm pays Nil Tax

Arms Length Price: The price at which two unrelated and non-desperate parties would agree to a transaction. Tax authorities want to insure that the inter-company price is equivalent to an arm's length price, to prevent the loss of tax revenue.

Permanent Establishment (PE):

The concept of PE comes into picture in case of an organization having its presence in different nations. **A PE gives rise to a tax liability.** The definition of permanent establishment in the OECD Model Income Tax Treaty is followed in most income tax treaties.

The commentary indicates that a fixed place of business has three components:

- **Fixed** refers to a link between the place of business and a specific geographic point, as well as a degree of permanence with respect to the taxpayer. An “office hotel” may constitute a fixed place for a business for an enterprise that regularly uses different offices within the space. By contrast, where there is no commercial coherence, the fact that activities may be conducted within a limited geographic area should not result in that area being considered a fixed place of business.
- A **place** of business. This refers to some facilities used by an enterprise for carrying out its business. **The premises must be at the disposal of the enterprise.** The mere presence of the enterprise at that place does not necessarily mean that it is a place of business of the enterprise. **The facilities need not be the exclusive location, and they need not be used exclusively by that enterprise or for that business.** However, the facilities must be those of the taxpayer, not another unrelated person. Thus, regular use of a customer’s premises does not generally constitute a place of business.
- **Business** of the enterprise must be carried on wholly or partly at the fixed place.

In case the establishment does not prove to be a PE the provisions of Section 9 of the Income Tax Act, 1961 shall apply.

Brief of Section 9 (IT Act 1961)

Classification	RESIDENT & ORDINARILY RESIDENT	RESIDENT & NOT ORDINARILY RESIDENT	NON RESIDENT
INCOME RECEIVED OR DEEMED TO BE RECEIVED IN INDIA	TAXABLE	TAXABLE	TAXABLE
INCOME ACCRUING OR ARISING OR DEEMED TO ACCRUE OR ARISE IN INDIA	TAXABLE	TAXABLE	TAXABLE
INCOME ACCRUING OR ARISING OUTSIDE INDIA FROM			
1) BUSINESS CONTROLLED IN INDIA OR PROFESSION SET UP IN INDIA	TAXABLE	TAXABLE	NOT TAXABLE
2) ANY OTHER SOURCE	TAXABLE	TAXABLE	NOT TAXABLE

Double Taxation Avoidance Agreement (DTAA):

DTAA is an arrangement between the tax regulators of one country with that of the other. **It revolves around the basic concept of “source” and “residence”.** A non-residents (say in India) income shall be subject to tax in India and also in the country of his residence, **as a resident’s global income is taxed.** Tax incidence, therefore, becomes an important factor influencing the non-residents in deciding about the location of their investment, services, technology etc.

E.g. Mr. Xing Xang a resident of China comes to India for a business trip. He earns certain amount of income in India with respect to same. Now keeping the provisions in mind the same income shall be taxed in India and also in China keeping in mind that he being a resident of China his global income shall be taxed. **To avoid this double taxation the government of India enters into DTA Agreements with various nations from time to time. The provisions of Section 90 of the Income Tax Act, 1961 shall be applicable**

A few countries with which India has DTAA

Australia, Bangladesh, China, France, Japan, Malaysia, South Africa, Sri Lanka, U.S.A etc.

U.S President Mr. Barack Obama also urged India to open itself to more and more Foreign Direct Investment in his recent visit. Also a happening in the case of International Taxation is that of the case between Vodafone and Indian tax authorities with claims amounting to ₹12,000 Crore plus. The CEO of Vodafone has rightly pointed out that all the future investments in India will depend on the outcome of this case. Henceforth the time has come when India starts imposing itself into a global perspective and bring in reforms accordingly.

Accounting

IASB proposes improvements to hedge accounting

The International Accounting Standards Board (IASB) has published for public comment an exposure draft on the accounting for hedging activities. The exposure draft proposes requirements that will enable companies to reflect their risk management activities better in their financial statements, and, in turn, help

investors to understand the effect of those activities on future cash flows.

The proposed model is principle-based, and will more closely align hedge accounting with risk management activities undertaken by companies when hedging their financial and non-financial risk exposures. The proposals also include enhanced presentation and new disclosure requirements.

Business and Corporate Laws

Business Laws

(i) **The Employees' Provident Funds & Pension (Amendment) Scheme, 2010 under the EPF & MP Act, 1952**

The Central Government through Notification No. G.S.R. 148 dated 11.09.2010 has made the **Employees' Provident Funds (Amendment) Scheme, 2010** by amending the Employees' Provident Fund Scheme, 1952. Further, the Central Government through Notification No. G.S.R. 149 dated 11.09.2010 has made the **Employees' Pension (Amendment) Scheme, 2010** by amending the Employees' Pension Scheme, 1995. These schemes lay down special provisions in respect to the International worker. For further details refer www.labour.gov.in

Corporate Laws

(ii) **The Companies Act, 1956**

The Ministry of Corporate Affairs through General Circular No: 6/2010 dated 03.12.2010 has decided to introduce a Scheme namely, **"Easy Exit Scheme, 2011"** under Section 560 of the Companies Act, 1956 to give an opportunity to the defunct companies, for getting their names struck off from the Register of Companies. The scheme will be in operation from 1st January, 2011 to 31st January, 2011.

The Central Government through Notification No. GSR 849(E), dated 15-10-2010 has **revised the Forms DIN-1 and DIN-3** by making the Companies (Director Identification Number) Rules, 2006 (Amend-ment) 2010 by amending Companies (Director Identification Number) Rules 2006. These rules shall come into force on the 5th day of December, 2010.

The Central Government through Notification No. G.S.R 848(E) dated 15-10-2010 has **revised Form No. 1 and Form No. 32** by making Companies (Central Government's) General Rules and Forms (Third Amendment), 2010 by amending Companies (Central Government's) General Rules and Forms, 1956. These rules shall come into force on the 5th day of December, 2010. For further details refer www.mca.gov.in

(iii) **The SEBI (ICDR) Regulations, 2009**

In exercise of the powers conferred by Section 30 of the Securities and Exchange Board of India Act, 1992, the Board has amended SEBI (Issue of Capital and Disclosure Requirement) Regulations, 2009 on 12th November, 2010 and these regulations are called the SEBI (Issue of Capital and Disclosure Requirements) (Fourth Amendment) Regulations, 2010. For further details refer www.sebi.gov.in

Income Tax

Significant Circulars/ Notifications issued by the CBDT in September and October, 2010

I. Circulars

1. Circular No. 6/2010 dated 20.9.2010

Regional Rural Banks not eligible for deduction under section 80P

The CBDT has, through this circular, reiterated that Regional Rural Banks are not eligible for deduction under section 80P of the Income-tax Act, 1961 from the assessment year 2007-08 onwards. It has also been clarified that the Circular No. 319 dated 11-1-1982 deeming any Regional Rural Bank to be cooperative society stands withdrawn for application with effect from A.Y.2007-08.

This is consequent to the amendment in section 80P by the Finance Act, 2006, providing specifically that w.e.f. 1-4-2007, the provisions of section 80P will not apply to any co-operative bank other than a Primary Agricultural Credit Society or a Primary Cooperative Agricultural and Rural Development Bank. The same has been further clarified by this circular.

2. Circular No. 7/2010 dated 27-10-2010

Clarification regarding period of validity of approvals issued under section 10(23C)(iv), (v), (vi) or (via) and section 80G(5) of the Income-tax Act, 1961

For the removal of doubts about the period of validity of various approvals granted by the Chief Commissioners of Income-tax or Directors General of Income-tax under sub-clauses (iv), (v), (vi) and (via) of section 10(23C) and by the Commissioners of Income-tax or Directors of Income-tax under section 80G(5) of the Income-tax Act, 1961, the CBDT has, through, this circular clarified the following:-

1. For the purposes of sub-clauses (iv) and (v) of section 10(23C), any notification issued by the Central Government under the said sub-clauses, on or after 13-7-2006 will be valid until withdrawn and there will be no requirement on the part of the assessee to seek renewal of the same after three years.
2. For the purposes of sub-clauses (vi) and (via) of section 10(23C), any approval

issued on or after 1-12-2006 under the said sub-clauses would be a one time approval and would be valid till it is withdrawn.

3. For the purposes of section 80G(5), existing approvals expiring on or after 1st October, 2009 shall be deemed to have been extended in perpetuity unless specifically withdrawn. Further, any approval under section 80G(5) on or after 1-10-2009 would be a one time approval which would be valid till it is withdrawn.

II. Notifications

1. Notification No. 77/2010 dated 11.10.2010

Section 80CCF provides a deduction to an assessee, being an individual or a Hindu undivided family, of the amount paid during the F.Y.2010-11 as subscription to long-term infrastructure bonds as may, for the purposes of this section, be notified by the Central Government subject to a maximum of ₹ 20,000.

The CBDT, has, through this Notification, notified the bonds, subscription to which would qualify for deduction under section 80CCF subject to certain conditions specified therein. These bonds have been named as "Long term infrastructure bonds" of India Infrastructure Finance Company Limited (IIFCL) and shall be issued during the financial year 2010-11.

2. Notification No. 80/2010 dated 19.10.2010

Deduction under section 80C is available in respect of any sum paid or deposited to effect or to keep in force a contract for such annuity plan of the Life Insurance Corporation or any other insurer as the Central Government may, by notification in the Official Gazette specify in this behalf.

Accordingly, the Central Government, has, through this notification specified the Tata AIG Easy Retire Annuity plan of the Tata AIG Life Insurance Company Limited as the annuity plan of the ICICI Prudential Life Insurance Company Limited for the purposes deduction under section 80C.

The complete text of the above notifications/circulars can be downloaded from the website of the Income-tax Department, www.incometaxindia.gov.in.

Indirect Taxes

A. Service Tax

Hire charges on electricity meter installed in consumers premises not liable to service tax

Transmission and distribution of electricity have been exempted from service tax vide **Notification Nos. 11 and 12 dated 27.02.2010 and 22.06.2010** respectively.

It has been clarified that supply of electricity meters for hire to the consumers is eligible for the above - mentioned exemptions for the reason that the same is an essential activity having direct and close nexus with transmission and distribution of electricity.

[Circular No. 131/13/2010 – ST dated 07.12.2010]

B. Excise Duty

Application of provisions of section 5A(1A) of the Central Excise Act

Notification No. 29/2004 CE dated 09.07.2004 as amended by Notification No. 58/2008 – CE dated 07.12.2008 granted full and unconditional

exemption to certain items of Textile Sector during the period 07.12.2008 to 06.07.2009 while another **Notification No. 59/2008 – CE dated 07.12.2008** prescribed a concessional rate of duty of 4% on these items, with the benefit of CENVAT credit during the said period.

The issue under consideration was that whether an assessee can avail the benefit of either of the two notifications whichever is beneficial to him or he is bound to avail the unconditional exemption under **Notification No. 20/2004 - CE**, as amended, during the period under dispute in terms of the provisions of section 5A(1A) of the Central Excise Act, 1944.

It has been clarified that in view of the specific bar provided under section 5A(1A) of the Central Excise Act, 1944, the manufacturer cannot opt to pay the duty under **Notification No. 59/2008 – CE dated 07.12.2008** and he cannot avail CENVAT credit of the duty paid on inputs.

[Circular No. 937/27/2010 – CX dated 26.11.2010]

Illustrations from Published Accounts- Auditing

Power Finance Corporation Ltd. — (31.03.2009)

Addendum to Director's Report 2008-09

Replies of Management to Auditors Report with regard to significant qualifications for the year 2008-09

Under Section 217 (3) of the Companies Act, 1956 the information to the Auditor's observations are submitted as under:-

1(a) On the Report of Statutory Auditors:-	
Observations	Replies of Management
<p>(a) Power Finance Corporation Limited (the Company) pursuant to the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) provided "Deferred Tax Liability" (DTL) on special reserve created under section 36(1)(viii) of the Income Tax Act, 1961 in the year 2004-05, by charging Profit & Loss Account with ₹142.87 crores and debiting the Free Reserves by ₹745.14 crores (for creating DTL for the years 1997-98 to 2003-04). Since, then the Company continued to provide DTL till the end of March, 2008 by charging Profit & Loss Account. The total amount towards DTL upto 31st March 2008 comes to ₹1228.38 crores. During the current year the Company has not provided the</p>	<p>On a representation made by the Company (after the receipt of Opinions of the EAC of ICAI) regarding the creation of DTL on Special Reserve created and maintained under section 36(1)(viii) of the Income Tax Act, 1961, the Company received a clarification from Accounting Standard Board of Institute of Chartered Accountants of India vide letter dtd. 02.06.2009. In accordance to the above, the company stopped creating DTL on Special Reserve created and maintained under I.T. Act, 1961 and also reversed the DTL on Special Reserve created in earlier years. This has also been suitably explained in the Accounting Policy No.13.2 of Accounting Policies (Schedule-17) and Note No.18 of Notes to Accounts (Schedule-18)</p>

<p>DTL amounting to ₹133.28 crores and has also reversed the DTL provided in earlier years amount to ₹1228.38 crores, contrary to the opinions expressed by the EAC of the ICAI (on two occasions dated 23.11.2004 & 18.05.2006) and contrary to the mandatory provisions of existing Accounting Standard – 22.</p> <p>In view of the facts and circumstances placed before us, the profits and Free Reserves of the company are overstated by ₹616.52 crores and ₹745.14 crores, respectively and DTL has been understated by ₹1361.66 crores. (Refer Note No. 19 of Schedule 18).</p>	<p>which are self-explanatory.</p> <p>Hence, there is no violation of Accounting Standard 22 or overstatement of Profits and Free Reserves and understatement of Deferred Tax Liability.</p>
<p>(b) As regards the liability of ₹908.94 crores (previous year ₹1066.75 crores) shown as “Interest Subsidy Fund from GOI” in the Balance Sheet, received under Accelerated Generation and Supply Program (AG&SP) Scheme from the Ministry of Power, Government of India, the Company has estimated the net excess amount of ₹283.14 crores (previous year ₹253.47 crores) and ₹44.27 crores (previous year ₹52.49 crores) as at 31st March, 2009, for IX and X plan respectively. This net excess amount is worked out on overall basis and not on individual basis and may vary due to change in assumptions, if any, during the projected period such as changes in moratorium period, repayment period, loan restructuring, pre payment, interest rate reset, etc. Hence, the impact of this excess, if any, could not be determined. As such, we are not in a position to express our opinion thereon (Note No. 15 of Schedule 18). Note No. 15 of Schedule No. 18 of Notes on</p>	<p>Accounts is self-explanatory and explains the method of claiming Interest Subsidy Fund, utilization, and excess worked out on overall basis based on projections made for loans sanctioned during IX & X plans, etc. The actual/exact excess due to difference between the indicative rate, period and assumptions considered at the time of drawl and at the time actual disbursement can be ascertained only after the end of the respective schemes. The Company will however return the net excess amount to Ministry of Power, if any, at the end of the respective schemes.</p>
<p>1(b) On the annexure to Auditors Report</p>	
<p>The management is carrying out the physical verification of fixed assets at the year-end in a phased manner excluding EDP equipments and Furniture & Fixtures lying at residences of the officers of the Company for which no physical verification was conducted. In our opinion, the frequency of physical verification is reasonable having regard to the size of the Company and nature of its assets.</p>	<p>Furniture & Fixtures and EDP Equipments are provided to the officers as per the Policy of the Company in their respective names and acknowledgement obtained and kept on record. Hence, physical verification on such items has not been considered necessary. Further, the amount involved in said assets is not material.</p>
<p>In our opinion and according to the information and explanations given to us, the Company has an internal audit system, which is commensurate with the size and nature of business of the Company. However, the same needs to be further streamlined and strengthened particularly in relation to IT aspects of the Company.</p>	<p>The Information Technology system audit is being conducted periodically and also the company is considering the implementation of ERP.</p>

According to the records of the company, there are no dues of income tax/ wealth tax/ service tax, etc., which have not been deposited by the company on account of any dispute except the unpaid demand of Income tax of ₹17.91 crore for the assessment year 2007-08 (Previous year ₹5.31 crore for the assessment year 2006-07) for which rectification application u/s 154 of the Income Tax Act, 1961 has been moved.

As explained in Note No.1(v)(a) of Schedule No.18 of Notes on Accounts which is self explanatory.

Solution to Case Study on VGCL (Chartered Accountant Students' Journal Nov. 2010)

Ammu s v d vijay bhaskar
SRO0212882

1. Assuming zero opening inventory, how should VGCL assign the production output (4,00,000 units) to the sales orders (4,00,000 units)?

	N71	N72	N73	N74	N75	Production
N71	90,000					90,000
N72	10,000	1,10,000				1,20,000
N73		30,000	60,000			90,000
N74			40,000	20,000		60,000
N75				20,000	20,000	40,000
Sales	100,000	1,40,000	100,000	40,000	20,000	4,00,000

2. Calculate and compare per unit cost of the series N rectifiers under an average costing system and under a relative sale value costing system?

Physical Unit Method : Average cost per unit = 2,00,00,000 / 4,00,000 = Rs 50 per unit.

Relative Sales Value Method :

Total Sales Value = Rs 246 lakhs

Gross Profit = Rs 46 lakhs = 19% margin on sales

Under this method, Unit cost = (sales price) x (1-0.19) = sales price x 0.81

	N71	N72	N73	N74	N75
Unit Cost	32	49	57	65	81

3. Compute revenue, cost and profit if the order of 6,000 units of N71 was accepted for immediate shipment? Computations need to be done using both physical unit costing and relative sale value costing systems.

Physical Unit System

Revenue 6000x Rs 40	2,40,000
Cost 6000 x Rs 50	3,00,000
Loss	60,000

Relative Sales Value Method

Revenue		2,40,000
Cost	3000 x 32	
Loss	3000 x 49	2,43,000
	Loss	3,000

4. What should Geetika advice regarding the order of the electrical manufacturing company?

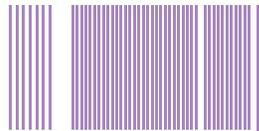
Relevant cost for decision making in this case is the opportunity cost per unit of Rs 15. Time value of money also to be taken into account.

5. Discuss the behavioural implications of using the physical unit method and the relative sale value methods of costing systems?

In case of use of physical unit system, substitution requiring sale of higher end products for lower end products will not reflect the right picture of profitability.

6. Give your opinion on the price and manufacturing strategy for the Indian Navy contract?

An additional 1,00,000 units of N74 for Indian Navy Contract will involve additional batches of production. Annual Sales of other products are to be augmented. Acceptance of the proposal is not feasible unless the whole sales prospects are reconfigured.



Solution to Case Study on ITC - E-Choupal (Chartered Accountant Students' Journal, Nov. 2010)

Arindam Dey (WRO 0285558)

1. Do you think large commercial organization should interfere with the established processes? Discuss

Large commercial organizations have a considerable influence over the society in a significant manner. In fact, their growth can be largely attributed to their critical understanding of the social environment in which they operate and adherence to the norm of giving it back to the society 'in letter and spirit'

Under such circumstances when established processes operate in such a manner that is largely prejudicial to the interests of the community at large as well as the business prospects of the organization, interference therein by the organization is bound to happen.

In the given case, the long established supply chain had distinctive lacunae which the company has rightfully recognized and has made efforts to bridge the gaps using their resources.

Therefore, large commercial organizations should involve with the established processes provided such interaction augurs well for the society.

2. Why mandies are not an optimal procurement channel for processors?

The entire supply chain for agricultural produce reaching the final consumer is solely dependent on 'mandies'. In the 'mandi' the farmers would bring their produce- which would be auctioned through an open outcry system and would be transferred to middlemen/brokers who pass it on to the next level of the distribution channel before it finally reaches the ultimate consumer.

The increased presence of intermediaries in the system implies adding up margins to the original price at each levels and ensures higher price levels, although the original producer i.e. the farmer with a poor bargaining power ending up with a meager share for his produce.

Hence, under such a system it is impossible for processors to supply their products at a price they desire owing to the increased cost of their raw materials i.e. 'agricultural produce'.

This is the major drawback due to which processors do not consider 'mandies' as an optimal procurement channel.

3. Was IT-driven solution a wise decision to implement in rural India?

The potential of Information Technology in transforming lives is a well accepted fact. In this backdrop, it would not be exaggeration to state that 'the power of Information Technology can radically change the face of rural India'.

Due to several infrastructural impediments implementation of IT driven solutions may not be a smooth ride but when various corporate initiatives like that of ITC start taking place and other factors get going the day wouldn't be far when rural India would feel empowered with the aid of IT driven solutions. The extensive use of IT enabled services shall remove time and distance barriers and foster agricultural and rural growth in a big way. Hence implementation of IT driven solutions in rural India was certainly a wise decision.

4. Why does the ITC select local farmers as sanchalaks?

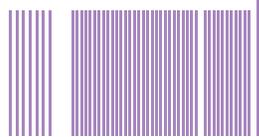
The very objective of setting up e-Choupals was to empower the farmers and enabling them to take their own decisions thereby reducing their dependency on other factors in the supply chain.

Therefore, it was apt to appoint the in-charge/sanchalaks of the internet kiosks from the farming community itself, whose knowledge of the local language would prove handy in establishing a link between the information systems and that with the farmers in providing timely and necessary information for their benefit.

5. What are the social benefits of e-Choupals?

The concept of e-Choupal implemented by ITC has proved to be a great boon for the agricultural community. Farmers are able to access real time information over the internet of weather and crop conditions, market situations, prevailing prices in international markets, etc. With adequate market knowledge they can reorganize their production pattern and volume as per demand and get better prices thereby.

Similarly for the company elimination on intermediaries implied -lowering of prices of raw materials, subsequent fall in final prices. This should result in larger consumer base and greater profits. In this manner e-Choupal has benefitted the entire society.



Highlights of the Annual Report of RBI: 2009-10

The worldwide financial crisis which started in 2007 took into its grip almost all the countries including India. The country which had been performing remarkably well since 2003 with 9% growth rate started decelerating in 2008-09 especially in the second half. In response to the emergent situation the macroeconomic policies were geared up. The focus of macroeconomic policies was on recovery and its management. The expansionary fiscal policy was adopted and monetary policy was made accommodative. As a result, not only the impact of sluggish private consumption and investment demand on economic growth was offset but an overall liquidity and interest rate condition was maintained that was conducive for growth. The stable financial system of India had a favourable impact on the overall business confidence and the economy began to pick up again in 2009-10.

Real Growth

India achieved 7.4 per cent growth in GDP in 2009-10. This was not only better than the 6.7 per cent growth achieved during the previous year but also was one of the highest in the world. Insufficient monsoons and gloomy global financial outlook were more than offset by a strong recovery in industrial sector and a resilient services sector.

Agriculture

In spite of deficient rainfalls, agricultural GDP registered a rise of 0.2 per cent in 2009-10 and total food stocks increased from 35.6 million tonnes at end-March 2009 to 43.4 million tonnes at end-March 2010 and further to 55.4 million tonnes as on August 1, 2010. The high level of food stocks and resilient production conditions suggest that with better supply management, the pressure on food inflation could have been moderated. The year 2009-10 witnessed sharp increases in food prices, particularly in pulses and sugar where demand supply imbalances at the margin led to a spurt in prices. Since agriculture is the mainstay of majority of the population, of about 52 per cent of the work force, it remains critical from the point of view of achieving the objectives of food security and price stability.

There is clearly a need for a renewed focus on improving agricultural productivity. The growth strategy, to be effective and inclusive, has to necessarily focus on stabilising the agricultural production by achieving improved efficiency and accelerated productivity levels in the farm sector.

Industry

The Index of Industrial Production (IIP) registered a growth of 10.5 per cent during 2009-10 (2.8 per cent in 2008-09). The recovery was broad-based with high growth in manufacturing industries (10.9 per cent), followed by mining (9.9 per cent) and electricity (6.0 per cent). The manufacturing output growth rate was supported by increases in consumer durables, capital goods and intermediate goods production.

During the current financial year 2010-11 (up to June 2010), industrial sector maintained double digit growth at 11.6 per cent. Notwithstanding some moderation in the pace of industrial growth due to base effect and possible subdued global demand, the industrial activity is expected to remain buoyant.

Infrastructure

During 2009-10, the six core infrastructure industries posted an improved performance over the previous year. During 2010-11 (up to April-June 2010), the infrastructure industries recorded a growth of 4.6 per cent, marginally higher than that in the corresponding period last year (4.3 per cent). Infrastructure remains a key constraint to growth in India. Both power generation/transmission and distribution continue to be the areas of concern.

Services

The services sector was significantly affected by global crisis. It witnessed growth moderation from 9.3 per cent in 2008-09 to 8.3 per cent in 2009-10 particularly because of deceleration in the "Community, Social and Personal Services" and partial withdrawal of fiscal stimulus. In the case of a number of services like hotels, communication, information and financial services, domestic demand continues to be the major driver of growth. Services dependent on external demand such as tourist arrivals, cargo handled at major ports and passengers handled at international terminals recovered during 2009-10, although remained below the pre-crisis levels. Domestic demand driven services such as commercial vehicle sales, cell-phone connections, and railway traffic and construction activity showed high growth, particularly during the second half of the year. Going forward, the services sector is likely to pick up further momentum from the growth in the manufacturing sector.

Inflation

Year-on-year wholesale price index (WPI) inflation remained low during the first half of the year 2009-10 (negative during June-August 2009) and increased faster in the second half to reach 11.0 per cent by March 2010. The base effect of high prices in the first half of 2008-09 contributed to the low inflation during the first half of 2009-10. The waning of base effect along with sharp increase in food and oil prices on account of lower agricultural production and increase in international commodity prices, especially oil, contributed to the faster increase in inflation during the second half.

Balance of Payments

Overall, India's exports and imports contracted by 3.6 per cent and 5.6 per cent, respectively, during 2009-10 as against a growth of 13.7 per cent in exports and 20.8 per cent in imports last year. As the decline in imports was steeper than the decline in exports, the overall trade deficit was lower during the year. Invisibles receipts and payments had witnessed deceleration in growth in 2008-09 in relation to the robust growth performance in the pre crisis period. During 2009-10, invisible receipts declined further by 1.4 per cent mainly on account of decline in business, financial and communication services and investment income receipts.

Despite the demand induced moderation in export growth resulting from the global recession, India's exports performed relatively better as its rank among leading exporters improved from 27th in 2008 to 22nd in 2009, with the share in world exports at 1.2 per cent. Overall, the macro-financial developments during 2009-10 indicated the resilience of the economy to shocks, both external and internal, as well as the capacity to recover fast from an economic slowdown.



CA. Amarjit Chopra, President, ICAI inaugurating the 'Thiru Vidya' Conference at Tirupati by lighting the lamp. Seen in picture (L to R).CA. Babu Abraham K,Chairman SIRC, CA. M. Devaraj Reddy, Central Council Member, C.Naresh, Secretary, SICASA, Dr.Ramachandra N. Galla, Chairman, Amara Raja Group Cos (Guest of Honour) CA.E. Phalguna Kumar, Chairman, SICASA, Padma Shri T.N. Manoharan, Past President, ICAI,CA.K.Manohar Naidu.committee Member.



A view of the Dais at the inaugural session of 'Thiru Vidya' Conference at Tirupati .Seen in picture (L to R) Ms.M.Sri Kripa,Vice Chair Person,SICASA,CA. M.Devaraja Reddy,Central Council Member, CA.V.Kamalakar,Chairman,Tirupati Branch,CA.Amarjit Chopra, President, ICAI ,CA.E.Phalguna Kumar,Chairman ,SICASA, Dr.Ramachandra N. Galla ,Chairman,Amara Raja Group Cos (Guest of Honour) Padmasri T.N.Manoharan,Past President ,ICAI, CA. Babu Abraham K,Chairman SIRC, CA.C.Mohan Reddy, Vice Chairman, Tirupati Branch, C.Naresh, Secretary, SICASA.



CA. Vinod Jain, Chairman, Board of Studies being felicitated at the 'Thiru Vidya' Conference by CA.K.Manohar Naidu of Tirupati.



Shri Henry Richard (Chief Guest) lighting the lamp at the inaugural ceremony of the National CA Students Conference in Mumbai. Also seen in picture CA Mangesh Kinare Secretary, WIRC, CA Neel Majithia (RCM), Ms Prapti Doshi, Secretary, WICASA, Rajesh Shah, Chairman-WICASA, CA Sanjeev Lalan,Chairman, WIRC, CA Pankaj Jain, Central Council Member, CA Vishnu Agarwal (RCM), Mr M A Razak (Addl Director, WIRC of ICAI, Mr Hardik Shah ,Member-WICASA.



CA Vinod Jain, Chairman, Board of Studies, presenting memento to Shri Henry Richard (Chief Guest) on the occasion of the National CA Students Conference held in Mumbai. January 2011 | The Chartered Accountant Student



Chief Guest Capt.Ganesh Karnik, MLC, Dy.Chairman, NRI Forum lighting the lamp at the inaugural ceremony of 16th annual conference organized by the Hubli Branch of SICASA at Vidyanagar, Hubli.



CA. Vinod Jain, Chairman, Board of Studies addressing the sub regional CA student's conference held on 12th December, 2010 at Jamnagar. Also seen in picture(L to R)Mr. Vishant Davda, Secretary WICASA, Jamnagar Branch, Mr. Vaibhav Mehta, Treasurer WICASA, Jamnagar Branch, CA. Ankur Doshi, Chairman WICASA, Jamnagar Branch, CA. Anand Raichura, Chairman Jamnagar Branch of WIRC of ICAI and Mr. Harshad Bagiya, Vice-Chairman WICASA, Jamnagar Branch.



Hon'ble Mr. Justice K. John Mathew inaugurating the Two Days CA Students' Conference at Kochi on 10th December 2010. Also seen in picture (L To R) CA. V. X. Jose, Member SIRC, CA. Babu Abraham Kallivayalil, Chairman SIRC, CA. Saji Mathew, Chairman, SICASA Ernakulam Branch, CA. E. Phalgun Kumar, Chairman SICASA, SIRC, Padma Shri. CA. T.N. Manoharan, Mr. Sherin Mathews, Secretary, SICASA Ernakulam Branch and CA. Vivek Krishna Govind, Chairman Ernakulam Branch.