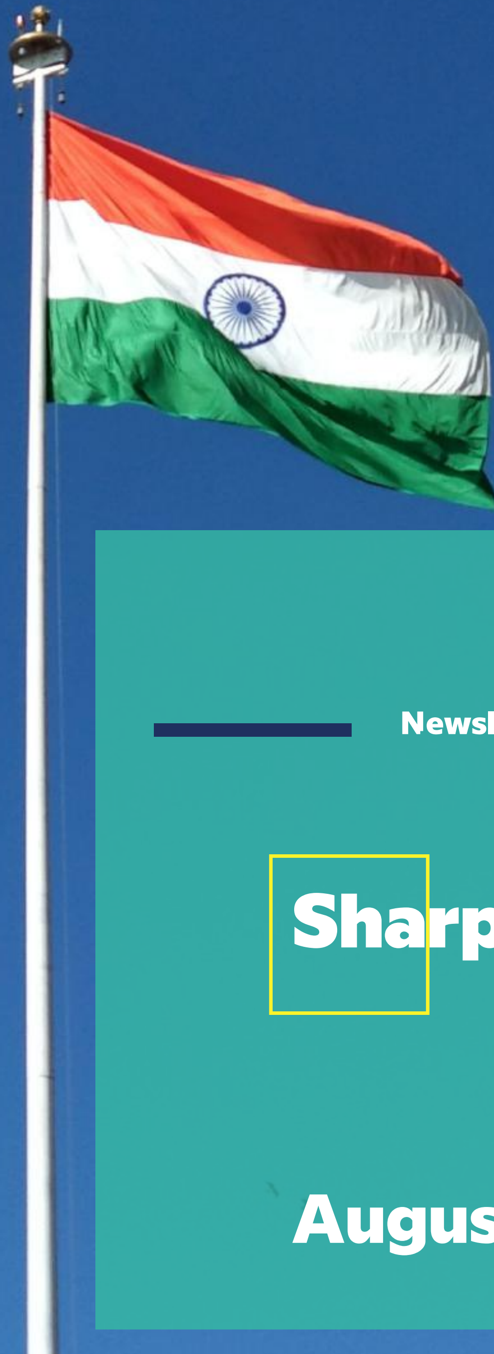


Newsletter

Sharp View

August 2021

SHARP & TANNAN

Assurance | Consulting | GRC | Taxation

Ahmedabad | Bengaluru | Chennai | Coimbatore | Delhi | Goa | Mumbai | Pune | Vadodara

August 21

Welcome colleagues. This issue of Sharp View is dedicated to the theme 'Independence.' When we say independence, the first thing which comes to our minds is 15th August, the Tricolor and our freedom fighters. Today, as we are nearing the 75th Independence Day, the definition of independence is just not the freedom, but denotes 'individuality', 'integrity' and 'strength.' We, as Chartered Accountants have demonstrated and will continue to demonstrate these elements in our professional journey.

Recent changes in corporate laws, SEBI guidelines, RBI regulations, and CARO 2020 have necessitated the auditors to carry out more extensive procedures while 'assuring' the stakeholders about the company's financial position. The stringent laws require the auditor to apply his best judgment while providing his opinion. Years 2020-21 and 2021-22 have posed uncertainties before many businesses across the globe, and the role of auditor here becomes more challenging than ever. The term 'integrity' and 'independence' need to be re-emphasized while discharging the functions of 'assurance.' The actual evolution of the economy can be depicted if the auditor uses his integrity, excellence and independence to assess the true financial position of the audited entity. While the laws have given adequate powers to the audit profession, it has also cast an equal responsibility of due diligence on the owners. The ownership, management and audit function, combined together can create wonders when aligned to a common objective of excellence and integrity.

'Independence', when exercised the true spirit, can make us as a nation survive, prosper, and flourish in the years to come.

Jai Bharat!

Assurance

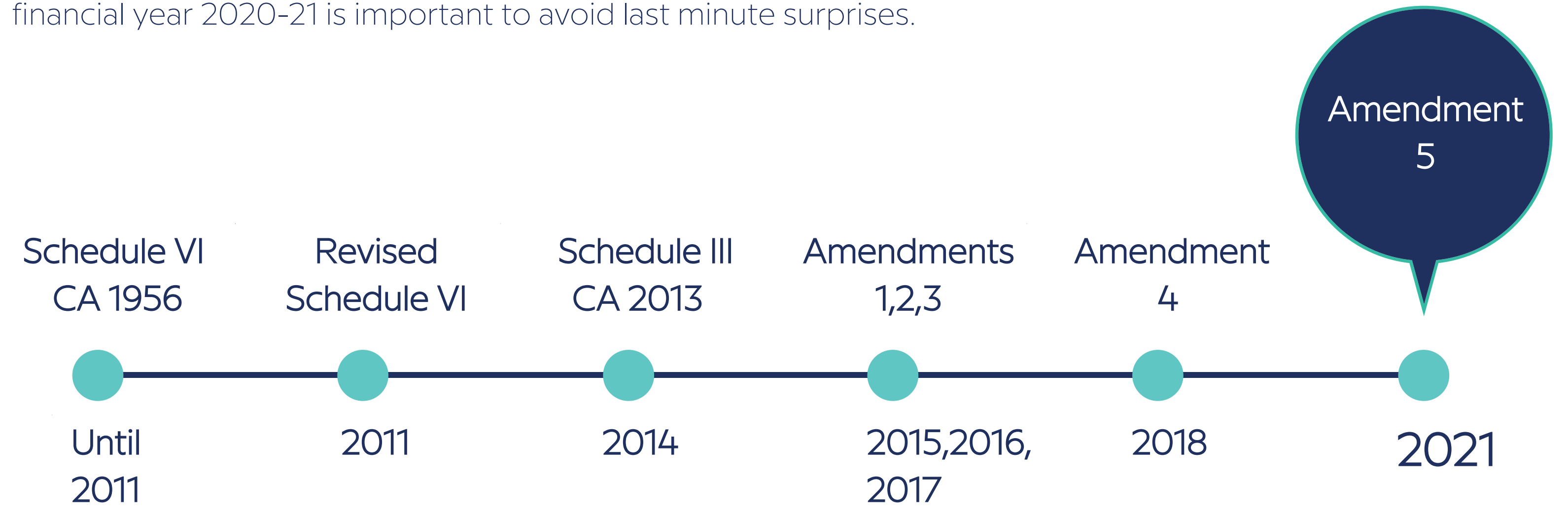
Schedule III Format of Financial Statements Revamped

On 24 March 2021, MCA notified the revised format of Schedule III to the Companies Act, 2013. Mr. Arjun M.K. explains how the said revision ensures improved financial reporting and enhanced governance, early red flags from auditors and increased transparency in disclosures as regards liquidity/solvency position of the company.

The Ministry of Corporate Affairs (MCA), on 24 March 2021, made amendments to Schedule III to the Companies Act, 2013 ('CA 2013') vide Notification G.S.R. 207(E). Amendments are made to all divisions of schedule III viz: Division I (financial statements prepared under AS for unlisted companies), Division II (financial statements prepared under Ind AS for listed companies) and Division III (financial statements prepared under Ind AS for NBFCs). The release of the notification turned out to be another distraction from the lethal virus for the community of auditors and the corporates who were gearing up for the year-end audits for financial year 2020-21.

Through these amendments we can expect improved financial reporting and enhanced governance from companies and early red flags from auditors; increased transparency in disclosures with respect to liquidity/solvency position of the company; identification of fund diversion and money laundering; and closer vigilance upon companies.

For the purposes of identifying and furnishing previous year comparatives for financial year 2021-22, the amended schedule III shall be applied for financial year 2020-21 as well since the same will have implications on regrouping, reclassification, presentation and disclosure of previous year comparative figures/notes accompanying the financial statements. Hence, a timely trial run for amended financial statements for the financial year 2020-21 is important to avoid last minute surprises.



New reporting requirements/areas where significant amendments have taken place are as follows:

a. Trade receivables and Trade Payables
b. Capital-work-in-progress (CWIP) and intangible assets under development (ITUAD)
c. Details of investing/trading in Crypto/Virtual currency
d. Companies Act provisions
e. Format, grouping, Financial Statement Line Item (FSLI)
f. New disclosures linked to CARO 2020

a. Trade receivables (TR) and Trade Payables (TP)

The sub-classification of TR is 'considered good', 'having significant increase in credit risk' and 'credit impaired' whereas the sub-classification of TP is 'due to MSME' and 'due to others'. These sub-classifications shall now be further disaggregated and presented into 2 more sub-categories - disputed and undisputed. The word 'disputed' is not

defined; it may be a legal dispute or dispute of any other nature. It is recommended that the management formulates a policy to apply consistency in identifying a dispute for the purpose of making this disclosure. The auditors need to agree upon the management's approach in formulating the policy and corresponding disclosure.

Ageing of TR and TP based on due date into <6M, 6M– 1Y, 1Y-2Y, 2Y-3Y, >3Y is now required to be disclosed. Companies may have different credit terms for each of their customers/class of customers. Similarly, the credit terms provided by vendors may differ according to the product or service availed. Special care to be taken wherever credit terms are specified in MSMED Act, 2006. ***Where no due date of payment is specified, ageing shall be from the date of the transaction.*** Many of the corporate ERPs generate ageing of payables based on ***invoice date***, but the disclosure is based on ***due date***. A complete list of credit terms with all its customers and vendors may be obtained and verified by auditors to ensure that the due dates are considered for the purpose of preparing the ageing for this disclosure. Specific attention from the audit team may be required for the cases which are classified as ***undisputed and not collected***, unless the same is classified as ***non-current receivables.***

The notification states that unbilled revenue (asset) and provision for expenses (liability) shall be disclosed under TR and TP as separate line items. Presently, unbilled revenue is disclosed either under other financial assets or other current assets, whereas provision for expenses is disclosed either under other current liabilities or under provisions. In our view, unbilled revenue cannot be disclosed as a trade receivable and, similarly unbilled dues (provision for liability) are not part of trade payables. We need to wait for further clarity on this aspect from the regulators / ICAI. Companies in EPC and IT & ITeS sectors specifically may have a significant impact in their disclosures because of this amendment.

b. Capital-work-in-progress (CWIP) and Intangible assets under development (IAUD)

The ageing of CWIP and IAUD into <1Y, 1Y-2Y, 2Y-3Y and >3Y and expected completion schedule of projects in progress as well as projects temporarily suspended shall be separately disclosed. Prior to this amendment, there were no disclosure requirements for CWIP and IAUD other than presenting the same as FSLI on the face of balance sheet.

The new disclosures on ageing are likely to influence the management to either capitalize the asset without any delay or provide for impairment for CWIP and IAUD which were not capitalized for significant period of time. The amendment also brings additional disclosure on expected time of completion & capitalization with respect to projects that have exceeded budgeted time (over-due) or costs (over-run) compared to its original plan. The risk of impairment is higher if the re-estimated time for completion of the project significantly exceeds the original plan. A similar disclosure on expected time of completion is required to be made for projects that are temporarily suspended. Subsequent events may lead to suspended projects becoming unviable, thus triggering impairment.

c. Details of investing/trading in crypto/virtual currency

Where the company has traded / invested in crypto / virtual currency during the year, the profit or loss on transactions involving crypto/virtual currency, amount of currency held as at the reporting date, deposits or advances from any person for the purpose of trading or investing in crypto/virtual currency shall be disclosed.

With the advent of crypto and virtual currencies, financial reporting also calls for extensive disclosures

considering its complexity and volatility. The new disclosure requirements may have a significant impact on the consolidated financial statements of the group having foreign subsidiaries dealing in cryptos. This amendment can be seen as a march towards enhanced corporate governance and regulation of crypto/virtual currencies. ***Presently, there is no AS/Ind AS governing crypto/virtual currency, the fact that there is no IFRS or US GAAP is also a notable point.*** It will not be a surprise if taxation laws and accounting standards evolve to cover these transactions soon.

Balances in secure digital wallets such as Paytm, PhonePe are digital currencies in the nature of cash and cash equivalents and are not a crypto/virtual currency. In India, several banks such as Yes Bank, ICICI Bank, Paytm Payments Bank Ltd. ended association with cryptocurrency exchanges (such as WazirX and BuyUCoin) and no longer support them. It will be interesting and challenging for the auditor to obtain sufficient and appropriate audit evidence to verify the disclosures made in connection with the existence (as at reporting date), valuation (including unrealized gain/loss) of cryptos and it may involve use of work of technical experts with expertise in blockchain technology. Realized profit or loss may be verified using actual cashflows and advances may be verified by obtaining an external confirmation.

Even though India has been cautious and virtual currencies have been heavily regulated, this amendment to Schedule III signals that we are moving in the direction to embrace these virtual currencies as investment.

d. Companies Act provisions

Details of charges or satisfaction yet to be registered with registrar of companies (ROC) beyond due date, details and reasons

This requirement may ensure strict compliance on timely filing of forms with ROC. Disclosure on any non-compliance will help lenders in identifying red flags with the borrowers, granting loans or financial assistance to companies who have a history of not creating/filing charges on time. Auditor shall obtain necessary explanations from company secretary and/or compliance officer and review information such as minutes of the board of directors and committee meetings, board resolutions, loan agreements and subsequent forms filed with MCA to ascertain the due date of filing a particular form with ROC.

Non-compliance with number of layers of companies, name and CIN of the companies beyond the specified layers and the relationship/extent of holding of the company in such downstream companies:

The Companies (Restriction on number of Layers) Rules, 2017 does not allow a company to have more than 2 layers of subsidiaries. This restriction was introduced to prohibit companies from misusing multiple layers of subsidiaries, by creating shell companies for diverting funds or money laundering.

Transactions with struck off companies, name and relationship, balance outstanding

Company shall implement controls for identification of struck off companies and updating details of existing vendors in the ERP. The ROC-wise list of struck off companies available on the website of MCA can be used for this process.

Not all transactions are required to be disclosed. Nature of transaction enumerated in the notification are investments in securities, receivables, payables, shares held by struck off company and other outstanding balances.

e. Format, FSLI and grouping

- Improved format of statement of changes in equity.
- New FSLI in balance sheet for lease transactions under Ind AS 116 Leases – 'Lease liabilities' (current and non-current).
- FSLI deleted in balance sheet – long term maturities of finance lease obligations under borrowings and current maturities of finance lease obligations under current liabilities.
- Change in grouping of current maturities of long-term debt from other current financial liabilities to short term borrowings and security deposits from loans/loans and advances to other financial assets/other non-current assets.

f. New disclosures linked to CARO 2020

The introduction of these amendments will help in aligning the auditors' report prepared as per CARO 2020 with the financial statements of the company. Before the amendment various information was required to be reported in the CARO 2020 report without corresponding disclosures in the financial statements.

Following are the new reporting areas:

- Details of change in revaluation of 10% or more under PPE and intangible assets, fair valuation by registered valuer for PPE, investment property, ROU assets and intangible assets.
- Title deeds of immovable properties not held in name of the company in the prescribed format.
- Details of benami property held.
- Details of quarterly statements submitted to bank and summary of material discrepancies /reconciliation with books, with reasons thereof.
- Details if the company is declared a willful defaulter.
- Details of utilization of loans received for specific purpose.
- Promoter shareholding details.
- Details of loans, advances, investments and guarantees given/taken to/from intermediaries and ultimate beneficiaries and declaration on FEMA compliance.
- Details of loans given to promoters, directors, KMPs and related parties under CA 2013.
- Eleven (11) financial ratios, formulae to be explained with reasons for variance more than 25%.
- Additional CSR disclosures.
- Details of undisclosed income surrendered or disclosed as income during the year in the tax assessments.

Other changes including change in division III for NBFCs

- 'Turnover' criteria for rounding off has been replaced by 'total income' criteria. Turnover is revenue from operations. Total income includes other income.
- In case of accounting for amalgamations (AS 14) / business combinations (Ind AS 103), compliance with approved scheme of arrangement as well as with the accounting treatment given in AS/Ind AS and deviation, if any, shall be explained.
- For section 8 companies, a new sub-FSLI introduced, namely, 'grants or donations received' under the note forming part of SOPL: 'Revenue from operations.' Hence, such grants and donations will be henceforth considered as operating income.
- Aligning terminologies used in division I (AS) with division II (Ind AS) such as replacing the phrase 'tangible assets' by 'Property, Plant and Equipment' on the face of balance sheet and 'total revenue' by 'total income' in sub-total line item on the face of SOPL.
- Amended division III requires disclosure of 4 NBFC specific ratios - capital to risk weighted assets ratio, tier I capital adequacy ratio (CRAR), tier II CRAR and liquidity coverage ratio.

Action points and the way forward

It is recommended that management carries out an impact assessment to understand the changes to be made in the standalone and consolidated financial statements template and acquaint the audit committee in this regard.

This also helps the management in identifying the risks in financial statement closure process (FSCP) and financial reporting disclosures process (FRDP) and thereby designing, implementing and maintaining internal controls relevant to the preparation and presentation of the financial statements.

There are certain disclosures relating to Companies Act provisions where the role of company secretary and/or compliance officer has become more important.

Also, whether the above amendments will be incorporated in the ERP or whether the amounts and disclosures will be manually prepared and reviewed – is another action point for the management to decide along with auditors and update the audit committee.

The amendments are crucial especially for listed companies and involves significant increase in efforts and changes to audit procedures. The auditors may review the management process involved and test the internal controls in place for financial reporting as part of audit of FSCP and FRDP.

ICAI has been releasing guidance notes after every significant change to financial reporting format in the past and we expect a guidance note for this latest amendment also. This will assist both the preparers and auditors to make better judgement in implementing this amendment to Schedule III.

GRC

Solvent Application in Plant - Risks & Control

Companies belonging to 'chemicals' and 'pharmaceuticals' industry use 'solvents' in their manufacturing processes. The use of solvents is crucial as they help complete a manufacturing process, without themselves undergoing any change. Thus, solvents can be re-used. Mr. Parth Adeshara discusses the key risks involved in solvent generation/recovery and the control procedures to be applied for minimizing the risks, wastages and optimizing the recovery.

Background

Solvent is a chemical substance which is used to dissolve, dilute, suspend or extract other substance or materials usually without itself undergoing any change (i.e. the solvent itself) or other materials used in the production process. In pharmaceuticals and chemical industry, solvents are widely used. Solvents can play a key role in the manufacturing process of pharmaceutical, chemicals, textiles, etc. Some of the common solvents used in pharmaceuticals and chemical industries are Acetone, Toluene, DMSO, Acetic Acid, HCL, IPA, etc. In this article we discuss the risks involved in solvent generation / recovery and the control procedures to be applied for minimizing the risks, wastages and optimizing the recovery.

A. Solvent Recovery Process

- The use of solvent depends upon the nature of process and product manufactured. In some cases, the usage is fixed as per the Bill of Material (BOM) and in some cases, it varies based on percentage of purity or on the reaction of any particular process.
- Solvent recovery is the process of extracting useful materials from waste/mother liquor or from by-product generated during the manufacturing process.
- Solvent generated from the process can be recovered and reused by the company in the manufacturing process. Solvent recovery can be done by various methods of distillations.
- Some companies prefer to recover solvent in-house while others prefer to use services of job workers or may dispose it off to Effluent Treatment Plant (ETP) or to vendors.

Why are solvents recovered?

- Organizations and industries generate solvents that can either be disposed off as waste or recycled into a usable resource. Solvent recycling can minimize wastages and cut down on disposal costs.
- Solvent recycling is important because it lowers the consumption of fresh raw material by reusing recovered solvent which in turn results into lowering material consumption cost.

Key risk areas at the time of solvent generation/recovery:

- After a batch run, recovery of solvents ranges significantly high due to percentage of purity or due to reaction of any particular process. Non monitoring of batchwise variation by not recording production logbook, can lead to unidentified controllable expensive solvent loss.
- Material content/purity analysis if not pre-agreed with job workers or, if untracked by the company may lead to receipt of lesser solvent recovery from job worker.
- Revenue loss if input-output norms are not tracked rigorously.

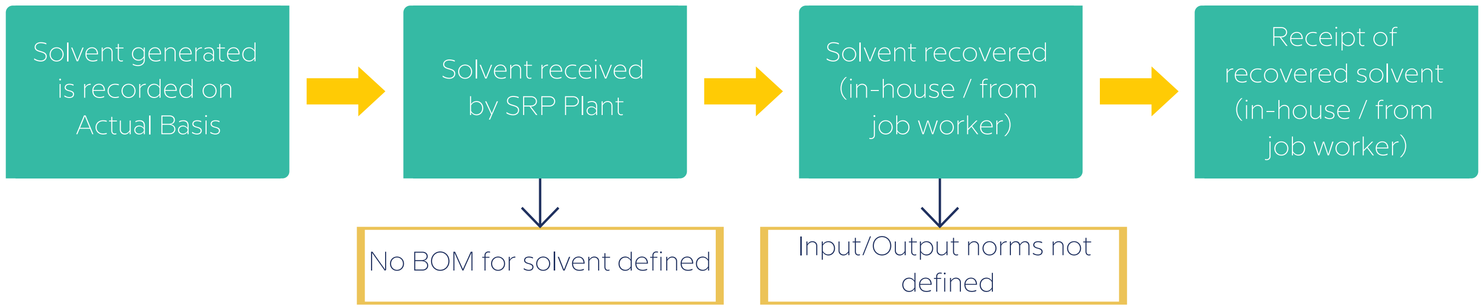
- X Ltd has entered into an agreement with multiple vendors for recovery of Acetone and DMSO through distillation. Processing charges thereof are paid to vendors for recovery of material. As per the agreement, X Ltd will send dilute Acetone and DMSO to the job workers and in return the job worker will provide the finished goods i.e., distilled DMSO and distilled Acetone to X Ltd. The clause w.r.t. content analysis is not mentioned in the agreement.

- Here, X Ltd does not perform content analysis either in-house or externally. As a result of this, there is no tracking mechanism available to measure the minimum recovery percentage as specified in the agreement. Thus, percentage of Acetone or DMSO lying in recovered material is missing which indicates receipt of lesser material by the company.

The way forward:

- BOM should be defined and maintained in system, and it should be reviewed periodically
- Input - output norms should be agreed with the job-worker / vendor in case of any material sent for recovery.
- Material balancing (i.e. reconciliation) should be carried out every time the material is received back or recovered from the job-worker / vendor.
- Reconciliation should be prepared and maintained by the company to verify whether the agreed recovery ratio is being adhered to.

- Process Generally Adopted:



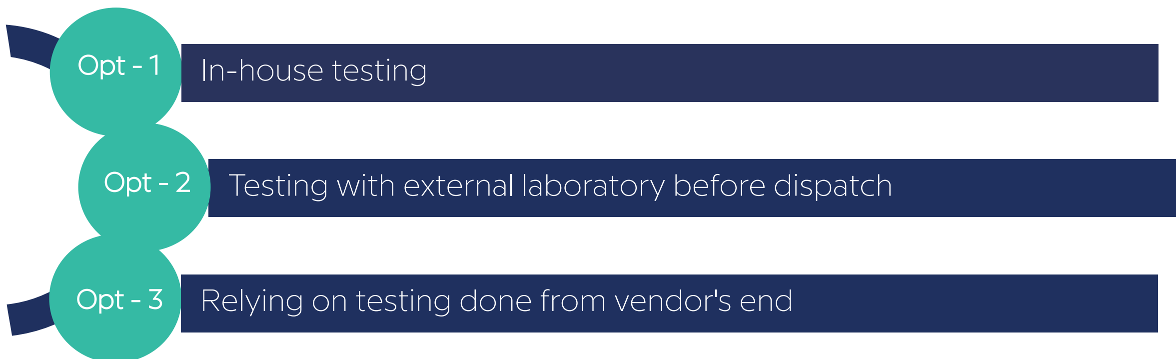
- Best Practice:

B. Solvent Disposal Process

- Solvents which cannot be recovered or reused in the production process are disposed off by the company. Generally, company sells such solvents/mother liquor to vendors who in turn recover fresh material by distillation process. Also, some companies dispose off the same in ETP.
- Mother liquor is part of a solvent that is left over after crystallization. It is a liquid obtained through crystal filtration.

Industry practices of disposing solvents:

Company performs purity testing/gas chromatography (GC) testing before obtaining quotations for selling solvents. Thereafter, quotations are obtained from the vendors and the vendor with highest rate is selected.
There are multiple practices followed by the company for performing purity/GC testing.



Why purity/GC/content testing is important ?

- As purity is a key parameter of the true chemical constitution of a substance, purity testing is the logical prerequisite for the accurate characterization of any material.
- The rate of solvent is decided based on content of material in solvent. Refer to below-mentioned illustration.:

Name of the spent solvent	Description	Quantity	Rate (Rs./Ltr)
Distilled Toluene	Distilled Solvent	Toluene - above 98%	18
		Toluene - 95% - 98%	16.5
		Toluene - 90% - 95%	14

In this illustration it is evident that the price of solvent is lineally related to content/purity of material present in the solvent.

Key risks in solvent disposal:

- Risk of sending fresh material instead of mother liquor as purity/content testing is not carried out while selling/transferring of material. Even, purity results of vendor are neither reviewed nor documented.

- X Ltd. wants to dispose Recovered Acetone, Dilute IPA, Mix Solvent. Being a USFDA approved pharmaceutical company, X Ltd does not perform content testing in-house. SCM department of X Ltd invites quotations on a monthly basis based on purity decided by plant team in the past. The vendors are allowed to do the sampling, in majority cases the vendor visits with his own equipment and tests the quality of the solvent, for which no records are kept by the company.

- Solvent Purity not factored, and Internal Cost Estimate not performed while inviting quotation from vendor

- ABC Ltd wants to dispose Recovered Acetone. SCM department of ABC Ltd invite 3 quotations on a monthly basis. Solvent is disposed off to vendor with the highest rate offered. Details of quotations received are depicted below:

Material Name	Quote 1	Quote 2	Quote 3
Recovered Acetone	16	17	18

The way forward:

- Independent testing of solvent should be carried out by the company as actual purity of the material may be higher than purity considered while rate negotiation.

Name of material	Purity considered for rate negotiation	Purity as per QC testing report	Total Qty Sold (Kg)	UOM
Recovered Acetone	94%	99.67%	5,78,851	Litre
Dilute IPA	90%	95.32%	6,64,693	Litre

a. In above case, SCM department should obtain rate of recovered acetone by considering actual purity i.e., 99.67% instead of previously decided 94% purity. This will result in an additional benefit of 5.67%.

b. The company should decide to conduct purity testing before dispatch of material, as the rates are linked with the Quality Control (QC) results.

- <u>Opportunity of better rate negotiation:</u>

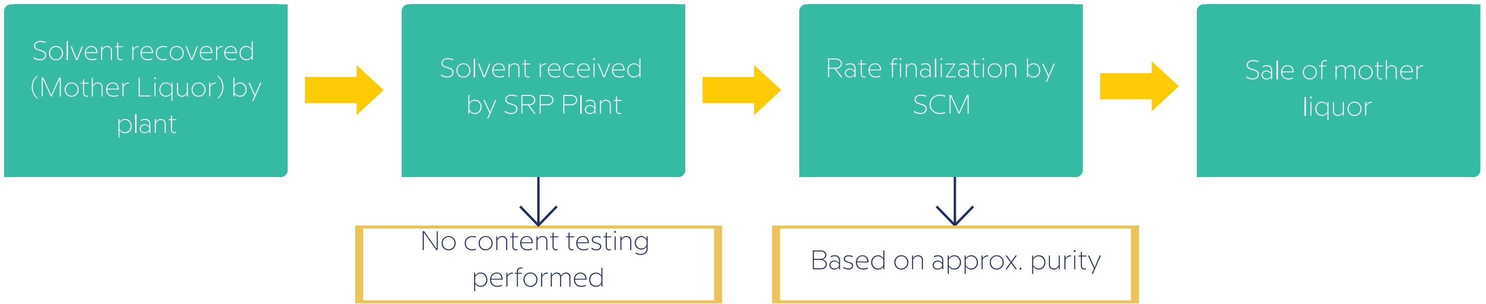
In case the company intends to recover the solvent from vendor, it should evaluate an option of preparing an Internal Cost Estimate (ICE) before negotiating the cost with vendors. The all-inclusive price which the company needs to pay to the vendor for the recovery process will include price for acetone, process cost for recovering acetone, vendor's profit margin and other components. This should be compared to the market price at which fresh solvent can be procured. Below-mentioned illustration depicts the potential for better negotiation with vendor by preparing ICE.

Name of the spent solvent	Rate (Per KG)
Price of Recovered Acetone (99.67% Purity)	18
Add: Utility cost (For distillation of recovered acetone)	1.5
Profit Margin @ 20%	3.6
Margin of Safety (Clean Slate factor) @ 10%	1.8
Total Cost to contractors	24.9
Rate of Fresh Material	30
Difference (Rs. Per Kg) i.e. Opportunity of cost saving	5.1
Opportunity of cost saving (%)	**20%**

In this illustration, vendor has given a cost of Rs. 18 per Kg for recovered acetone. While preparing ICE, cost of purchasing material by vendor, processing cost for recovery of solvent, profit margin, clean slate factor have been considered for arriving at total cost of Rs. 24.9 per kg to be incurred by vendor. Price of fresh material is Rs. 30 per Kg at the same time.

Thus, there is potential to better negotiate with vendor if ICE is prepared by SCM department.

- Process generally Noted:



- Best Practice:

Taxation

Frequently Asked Questions on various doubts related to compliance with section 194Q

Over the last year, Central Board of Direct Taxes (CBDT) has introduced TDS and TCS provisions requiring the buyers and sellers to make TDS/TCS. Sale and purchase are the flip-side of a transaction and applicability of two provisions on the same transaction created a lot of doubts in the minds of assessees. To resolve these doubts, Mr. Pramod Bhise and Ms. Aarti Joshi present the elucidation in form of FAQs.

The Finance Act, 2020, inserted sub-section (1H) in section 206C to provide for the collection of tax (TCS) by a seller from the amount received as consideration for the sale of goods if it exceeds INR50 lakh in any previous year. On similar lines, the Finance Bill, 2021, inserted a new section 194Q to provide for deduction of tax (TDS) by a buyer on the purchase of goods. As sale and purchase are the flip-side of a transaction, the applicability of two provisions on the same transaction created a lot of doubts. To resolve these doubts we have prepared few FAQs about the requirement to deduct TDS on purchase of goods with effect from 1 July 2021 with a distinction between the new section 194Q and section 206C(1H).

FAQ 1. Who is liable to deduct tax u/s 194Q and when?

TDS shall be deducted by a buyer carrying on a business whose total sales, gross receipts or turnover from the business exceeds INR10 crore during the financial year (FY) immediately preceding the FY in which such goods are purchased. This provision shall be applicable from 1 July 2021. TDS shall be deducted from the purchases made by a buyer if the following conditions are satisfied:

a. There is a purchase of goods from a resident person;
b. Goods are purchased for a value or aggregate of value exceeding INR50 lakh in any previous year (PY); and
c. The buyer is not in the list of persons excluded from the provision for deduction of tax.

It should be noted that, provisions of section 194Q shall not apply to buyer in the year of incorporation, since the condition of turnover of INR10 crore in the preceding year would not be satisfied (Clarified vide Circular No 13 / 2021 dt. 30 June 2021). ·

FAQ 2. What shall be the timing and rate of TDS?

TDS is required to be deducted at the time of credit of such sum to the account of the seller or at the time of payment thereof by any mode, whichever is earlier. TDS shall be deducted even if the sum is credited to the 'Suspense Account'. TDS shall be deducted by the buyer of goods @ 0.1% of the purchase value exceeding INR50 lakh if the seller has furnished his PAN or Aadhaar, otherwise, the TDS shall be deducted @ 5%.

FAQ 3. Where a transaction is covered by both the provisions - TDS u/s 194Q and TCS u/s 206C (1H), who shall be liable for deduction/collection of tax?

Second proviso to section 206C(1H) provides that if the buyer is liable to deduct tax under any other provision on the goods purchased by him from the seller and has deducted such amount, no tax shall be collected on the same transaction. Section 194Q(5) provides that no tax is required to be deducted by a person under this provision if tax is deductible under any other provision or tax is collectable u/s 206C [other than a transaction on which tax is collectable u/s 206C (1H)]. Though section 206C (1H) excludes a transaction on which tax is actually deducted under any other provision (which will cover section 194Q as well), section 194Q (5) does not create a similar exception for a transaction on which tax is collectable u/s 206C (1H). Thus, the buyer shall have the primary and foremost obligation to deduct TDS and no tax shall be collected on such transaction u/s 206C (1H). However, if the buyer makes a default, the liability to collect the tax gets shifted to the seller.

FAQ 4. Is a buyer importing goods from outside India required to deduct tax at source under this section?

The provisions of section 194Q shall not apply to a non-resident whose purchase of goods from seller resident in India is not effectively connected with the permanent establishment (PE) of such non-resident in India. For this

purpose 'PE' shall mean to include a fixed place of business through which such business of the enterprise is wholly or partly carried on. (Circular No 13 / 2021 dt. 30 June 2021).

FAQ 5. Is TDS required to be deducted from the goods exported abroad?

In the transaction of export of goods, the seller is a resident but the buyer is a non-resident. Thus, the liability to deduct tax under this provision may arise on the non-resident buyer, which may not be practically possible. Thus, the Central Government may exempt such transactions in view of the powers given by the explanation to section 194Q.

FAQ 6. Is tax required to be deducted when the seller is a person whose income is exempt?

When the seller is a person who is exempt from tax (under section 10, or under any Act of the Parliament – RBI Act, ADB Act, etc.) then TDS is not to be deducted. However, this exemption is not allowed if only a part of the seller's income is exempt under the IT Act. (Circular No 13 / 2021 dt. 30 June 2021).

FAQ 7. In absence of any definition of 'goods', what shall be construed as a purchase of goods?

The term 'goods' is not defined in the IT Act. The term 'goods' is of wide import. Anything which comes to the market can be treated as goods. 'Goods' have been defined under Sale of Goods Act, 1930 and also Central Goods and Services Tax Act, 2017. As such, the tax is to be deducted under this provision from the purchase value of movable property, any commodity, shares or securities, electricity, agriculture produce, fuel, motor vehicle, liquor, jewellery or bullion, art or drawings, sculptures, scraps, forest produce, etc. unless the same is specifically exempt by the provisions of IT Act. Also, refer to FAQ 8 below.

FAQ 8. Whether transactions in securities through stock exchanges and transactions in electricity shall be subject to TDS?

Provisions of section 194Q shall not be applicable in relation to i) transactions in securities and commodities that are traded through recognized stock exchanges or cleared and settled by the recognized clearing corporation, including recognized stock exchanges or recognized clearing corporation located in International Financial Service Centre and ii) transactions in electricity, renewable energy certificates and energy saving certificates traded through power exchanges registered in accordance with Regulation 21 of the CERC (Circular No 13 / 2021 dt. 30 June 2021).

FAQ 9. Is TDS required to be deducted on purchase of immovable property by a developer?

Immovable property shall not be treated as 'goods'. Consequently, TDS shall not be deducted from the purchase of immovable property by a developer. TDS shall be deductible on consideration paid for purchase of immovable property (other than agricultural land) under section 194-IA and not under this section.

FAQ 10. Whether TDS should be deducted on the purchase of software?

The Supreme Court in its landmark decision of Tata Consultancy Services v. State of A.P [2004] 141 Taxman 132 (SC) held that canned software (off the shelf computer software) are 'goods'. Hence, purchase of canned software (off the shelf computer software) is purchase of 'goods' and will be liable to TDS u/s 194Q even if buyer-entity capitalises the same in its books. Purchase of customised or tailor-made software may be 'services' and liable to TDS u/s 194J or 194-O.

FAQ 11. Whether TDS is to be deducted on purchase of jewellery not connected with business?

If a person falls within the definition of the buyer, tax is required to be deducted even if such purchase is not connected with the business carried on by him. Jewellery, being a movable property, is covered within the term goods. There is no specific exclusion u/s 194Q for deduction of TDS on purchase of jewellery.

FAQ 12. Whether additional, allied and out-of-pocket expenses form part of the purchase value of goods?

It is imperative to accurately determine the purchase value as it is relevant both for the applicability of the provisions and the amount from which tax should be deducted. Additional, allied or out-of-pocket charges recovered from the customers may or may not form part of purchase value. Where these expenses have been reflected in the purchase invoice itself, it should form part of purchase value. If they are charged through a separate invoice and backed up by the proof of expenses, it should not form part of purchase value.

FAQ 13. Will TDS u/s 194Q apply to redemption of preference shares by a company?

Preference shares are movable property and goods. In Anarkali Sarabhai v. CIT [1997] 90 Taxman 509 (SC), the Court held that redemption of preference shares is clearly 'sale' by the shareholder to the company and would come within the purview of 'transfer'. Therefore, it would appear that if redemption proceeds to any preference shareholder exceed INR50 lakh limit, TDS provision would apply. However, exemption as mentioned in FAQ 8 applies to redemption of preference shares as well.

FAQ 14. Will TDS u/s 194Q apply to buyback of shares by a company? Will such buyback amount to purchase of goods?

It would clearly amount to purchase of goods in view of Supreme Court decision in Anarkali Sarabhai v. CIT [1997] 90 Taxman 509. Besides section 68 of the Companies Act, 2013 dealing with buyback of shares refers to it as purchase in the section heading as well as text of the provisions. However, buyback of shares by domestic companies are subject to 20% tax u/s 115QA of the IT Act and the consideration is exempt from tax in the hands of the shareholders u/s 10(34A). So it will be a case of fully tax-free income being subjected to TDS. Besides, section 115QA(4) says that the tax paid by the company under that section shall be treated as final payment of tax in respect of distributed income on buyback of shares. In view of the above, it appears no tax u/s 194Q shall be deductible on buyback of shares. It is better for CBDT to clarify this in 'removal of difficulties guidelines.' However, exemption as mentioned in FAQ 8 applies to redemption of preference shares through recognised stock exchanges.

FAQ 15. A company having turnover above INR10 crore in the immediately preceding FY buys INR75 lakh capital goods from a supplier. As consideration, the company allots to the supplier, shares of INR1 lakh (whose fair market value is INR75 lakh.) Is TDS deductible u/s 194Q?

If we go by the plain meaning of 'purchase of goods,' there is indeed a purchase of goods. And the term 'payment thereof by any mode' does not exclude payment in kind. Issue of shares in consideration for capital goods is clearly 'payment in kind' and also 'payment in any mode.' Hence, TDS will have to be deducted at the time of credit of INR75 lakh to supplier's account or at the time of allotment of shares, whichever is earlier.

FAQ 16. How is TDS adjusted for purchase returns?

If purchase returns happen after making TDS, the TDS on returned goods should be adjusted in the next purchase against the same seller. In case, goods are replaced by the seller, no TDS adjustment is required.

FAQ 17. Will section 194Q apply to loan of material?

E.g. Trader X takes some goods on loan from Trader Y. Trader X commits to replace to Trader Y the quantity taken when his own stocks arrive. This is loan of material. Section 194Q applies to purchase of goods and not loan of material.

FAQ 18. From which date the threshold limit of INR50 lakh will be computed?

Finance Bill, 2021, had inserted section 194Q, w.e.f. 1 July 2021, to provide for the deduction of tax on certain purchases. The threshold of INR50 lakh shall be computed from 1 April 2021. Thus, if a buyer has already purchased goods of value INR50 lakh or more up to 30 June 2021 from a seller, TDS under this provision shall apply on all purchases on or after 1 July 2021.

FAQ 19. Whether TDS is to be deducted on the total invoice value including GST?

TDS is required to be made at time of credit or payment, whichever is earlier, hence i) If the payment is against the invoice, where GST is mentioned separately, then GST is to be excluded from the total invoice value for calculating TDS and ii) If the payment is made prior to invoicing, TDS is to be deducted on the entire payment, as it is not possible to identify that payment with GST component of the amount to be invoiced in future. (Clarified vide Circular No 13 / 2021 dt. 30 June 2021).

FAQ 20. Whether TDS has to be deducted on advance payment made to the seller?

As the provisions apply on payment or credit whichever is earlier, the provisions of section 194Q shall apply to advance payment made by the buyer to the seller. (Clarified vide Circular No 13 / 2021 dt. 30 June 2021).

FAQ 21. Whether payment of advance before 1 July 2021 for purchase of goods will be subject to TDS?

Finance Bill, 2021, had inserted section 194Q with effect from 1 July 2021. Thus, provisions of this section shall not apply on any payment made or credit made in the books of accounts before 1 July 2021. Consequently, it would apply to all purchases made on or after 1 July 2021. In simple words, TDS should be deducted where the payment is made or amount is credited on or after 1 July 2021. Thus, where any of the trigger events (i.e., payment or credit) have occurred before the date of applicability of provision, no liability to deduct tax will arise.

FAQ 22. Whether the amount advanced as a loan to the seller shall come within the ambit of this provision?

Requirement to deduct TDS arises if the purchase value exceeds the threshold limit during the PY. The deduction is to be made at the earliest of payment or credit for the purchase of goods. Since the loan advanced by buyer is not a payment towards the purchase of goods, it shall remain outside the purview of this provision. Hence, there is no requirement to deduct TDS on loan advanced by the buyer. However, if at any future date, such loan amount is settled against purchased value, the liability to deduct TDS shall arise. The tax shall be deducted on the date on which parties agree to adjust the loan amount against the outstanding liability.

FAQ 23. Whether tax to be deducted on the purchase of goods by one branch to another?

The existence of two distinct parties as 'seller' and 'buyer' is a prerequisite to construe a transaction as purchase. The condition of purchase is not fulfilled in the context of branch transfer. Therefore, the provisions of this section shall not apply in the case of branch transfers.

FAQ 24. What shall be the treatment of debit note for computation of TDS?

As the tax has to be computed on the purchase value, the adjustment made to the ledger of the seller by issuing the debit note will not have an impact on the tax to be deducted. The position would remain the same if, after the deduction of tax, the seller repays some consideration to the buyer. In such a situation, the amount of purchase value shall not be reduced with the amount so refunded or the debit note so adjusted for calculation of TDS.

FAQ 25. If the seller has multiple units, whether purchases made from different units need to be aggregated?

If different units of the seller are under the same PAN or Aadhaar number, the amount paid or payable to all such units shall be aggregated to compute the limit of INR50 lakh.

FAQ 26. Can a seller apply for the certificate for lower deduction of TDS?

The assessee does not have the option to approach the assessing officer to issue a certificate for a lower tax deduction or to file declaration for nil deduction in respect of transactions covered u/s 194Q, since section 206C (1H) also does not allow the buyer to apply for the lower or nil TCS certificate.

FAQ 27. How to deposit the TDS?

Assessee will have to make payment of tax (including TDS) electronically through internet banking facility or by way of debit cards. To deposit the tax, the deductor has to fill the Challan No ITNS 281. Other deductors can deposit the tax so deducted into any branch of RBI or the State Bank of India or any authorized bank.

FAQ 28. What are the due dates to deposit TDS, consequences for failure to deduct or pay TDS and consequences of non-filing of TDS return?

The present provisions related to due dates of payment of TDS, consequences for delay or failure in payment and consequences of non-filing of TDS return apply to TDS u/s 194Q as well. Late filing fees u/s 234E and penalty u/s 271H is also levied in case of furnishing of inaccurate information under TDS return.

FAQ 29. Whether buyer shall be treated as assessee in default if the seller pays the tax due on the income declared in the return of income?

Section 201 provides that a deductor, who fails to deduct tax at source, is not deemed to be in default if the payee has considered such amount while computing income in the return and has paid the tax due on such declared income. The deductor will have to obtain a certificate to this effect from a Chartered Accountant in Form No 26A and submit it electronically. Thus, the buyer shall not be deemed as assessee-in-default if the seller has taken into account the purchase amount while computing his income and has paid the tax due on the income declared in the return.

FAQ 30. What is cross application of section 194-O, section 206C (IH) and section 194Q?

Considering the rapidly increasing volume and value of digital transactions, section 194O was introduced w.e.f. 1 October 2020, requiring an e-commerce operator to deduct TDS (@ 1%) at the time of credit / payment of the sale proceeds, whichever is earlier, to the account of e-commerce participant (seller). If the e-commerce participant is an Individual / HUF whose entire income is exempt from tax and the amount payable to him does not exceed INR5 lakh, TDS provisions will not apply. As per Circular No 13 / 2021 dt. 30 June 2021, following points were clarified:

1. If tax has been deducted by the e-commerce operator on a transaction u/s 194O [including transactions on which tax is not deducted on account of section 194O(2)], that transaction shall not be subjected to tax deduction u/s 194Q.
2. Though section 206C (1H) provides exemption from TCS if the buyer has deducted TDS on goods purchased by him, to remove difficulties it is clarified that this exemption would also cover a situation where instead of the buyer the e-commerce operator has deducted TDS on that transaction of sale of goods by seller to buyer through e-commerce operator.
3. If a transaction is both within the purview of section 194O as well as section 194Q, tax is required to be deducted u/s 194O and not u/s 194Q.
4. Similarly, if a transaction is both within the purview of section 194O as well as section 206C (1H), tax is required to be deducted u/s 194O of the Act.
5. It is clarified that here primary responsibility is on e-commerce operator to deduct the tax u/s 194O and that responsibility cannot be condoned if the seller has collected tax u/s 206C (1H). This is for the reason that the rate of TDS u/s 194O is higher than the rate of TCS u/s 206C (1H).
6. If a transaction is both within the purview of section 194Q as well as section 206C (1H) TDS is required to be deducted u/s 194Q. The transaction shall come out of the purview of section 206C (1H) after TDS has been deducted by the buyer on that transaction. Once the buyer has deducted TDS on a transaction, the seller is not required to collect TCS u/s 206C (1H) on the same transaction. However, if, for any reason, tax has been collected by the seller u/s 206C (1H), before the buyer could deduct TDS u/s 194Q on the same transaction, such transaction would not be subjected to tax deduction again by the buyer. This concession is provided to remove difficulty, since the rate of TDS and TCS here are the same.

Consulting

SEBI - Independent Directors - Review of Regulations

Recently, the Securities and Exchange Board of India (SEBI) has reviewed the regulatory provisions for the appointment of independent directors on the boards of listed entities. This move is expected to further strengthen their independence and enhance effectiveness in protection of the shareholders' interest (including minority shareholders) and other functions. Ms. Aarti Joshi summarizes the key provisions of the reviewed regulations.

Recently, the Indian regulators have been strengthening the existing operational and legal framework of the corporates by infusing greater transparency in the systems. This is done either by introducing new regulations or modifying existing regulations in operations and reporting. Very recently, SEBI has reviewed the regulatory provisions for appointment of independent directors (IDs), which will take effect from 1 January 2022. Six months hence, the following will be the legal position as regards the IDs of listed entities:

I. Eligibility

1. For appointment as ID, a cooling off period of 3 years has been introduced for Key Managerial Personnel (KMP) and their relatives, or employees of the promoter group companies.
2. Relatives of employees of the company, its holding, subsidiary or associate company have been permitted to become IDs, without the requirement of a cooling off period.

II. Appointment

1. Appointment/re-appointment and removal of IDs shall be through a special resolution of shareholders (instead of the present ordinary resolution).
2. The nomination and remuneration committee (NRC) will now be entrusted with a greater responsibility to prescribe a skill-set which a candidate for the post of ID must possess and also to disclose whether the proposed candidate fits into that skill-set.
3. From the calendar year 2022, NRC will comprise of 2/3rd IDs instead of present requirement of a simple majority (i.e. more than 50%).
4. In order to reduce the delay in accepting the appointment of the ID, such appointment shall be approved by the shareholders in the next general meeting or latest by 3 months after the appointment.

III. Resignation

1. The existing LODR required the ID to disclose the reasons of his resignation, however as per the reviewed regulations, the entire resignation letter of an ID shall be disclosed to the stock exchanges by the listed entity along with a list of his/her present directorships and memberships in board committees.
2. To accept whole-time directorship in the same company/holding/subsidiary/associate/ or any company of the promoter group, the minimum cooling off period is 1 year from the date of resignation.

IV. Audit Committee

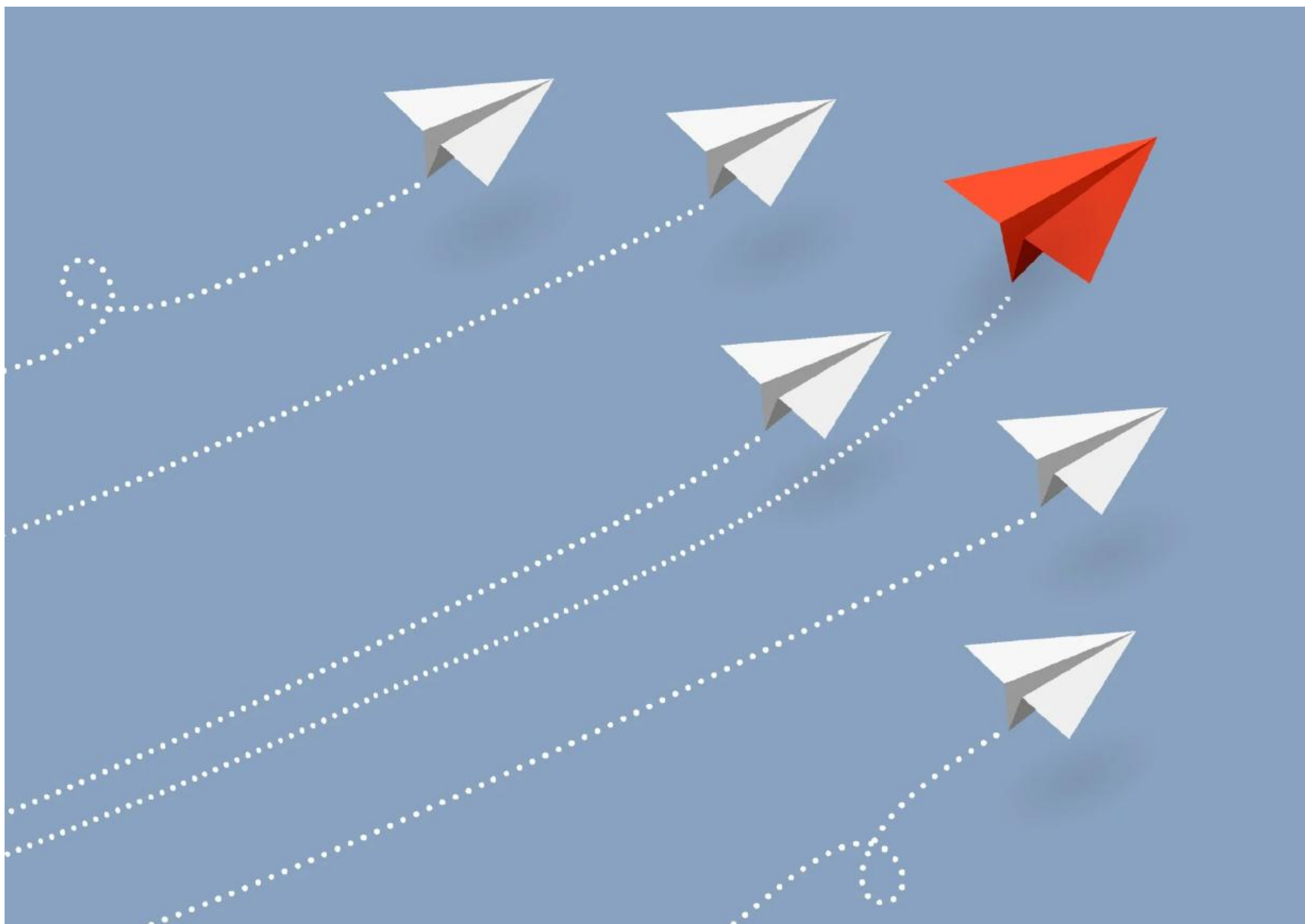
At least 2/3rd of the audit committee members shall be IDs and all related party transactions shall be approved by only IDs on the audit committee.

V. Remuneration

The present law does not permit stock options to IDs. However, to balance the objective of greater efficiency as well as to preserve the independence, it is referred to MCA to decide whether ESOP (employee stock option plan) can be included to be a part of the remuneration, along with sitting fees, profit linked commissions in respect of all the directors (including IDs).

Our View: Putting 'independence' at the forefront, will definitely strengthen the decision-making process. Making the Boards operationally independent will help striking a healthy balance between the interests of the promoters and other stakeholders, including minority shareholders.

However, permitting stock options to IDs is not a healthy move as this would compromise the independence of the IDs. This was permitted earlier but was discontinued by SEBI as the value of stock options were such as to make the appearance of independence, if not actual independence, questionable. If at all it is to be introduced, the quantum of ESOPs (in terms of value) should be regulated by law.



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