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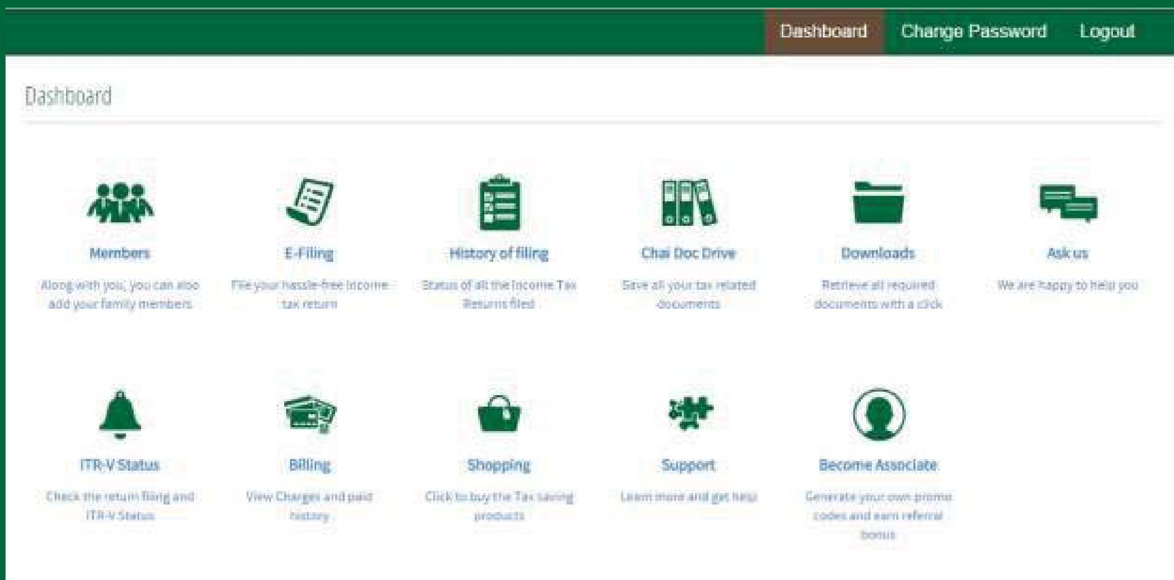

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CONTENTS

COMPANIES ACT

BOARD'S REPORT UNDER COMPANIES ACT, 2013 – CONTENTS THEREOF - AN ANALYSIS

Contributed by CS Phanindra DVK

Preparation of Board's Report under the Companies Act, 2013, can be co-related to putting a jig-saw puzzle in place, because of the quantum of information that needs to be obtained and put in place for the same.

It is a welcome move that there are lot of disclosures/information which are required to made by the Board of Directors in their report, which in turn enables transparency as to the operations and management in the company, thereby better Corporate Governance.

It is observed that most of the disclosures which are required to be given in the Board's Report including its Annexures, and those in the Annual Return, are arranged in such a way so as to cross-verify/correlate one fact with a figure somewhere mentioned, or a figure with a fact. **For example,** if a Company discloses some information as to related party transactions on arms-length basis in AOC-2 (which is an annexure to the Board' Report), then there is a disclosure in the Annual return (MGT-7) in which the company needs to give the details of filings as to the members approvals obtained for the same.

Preparation of Board's Report varies from company to company and depending upon the nature of business, transactions and other criteria, and accordingly, Report of one Company cannot be used as a template, as such, for another company.

The provisions as to Board's report are contained in Section 134 of the Companies Act, 2013 and rules framed thereunder, and the same are applicable to all the companies including Small Companies and One Person Companies [OPCs], except for some of the disclosures which are applicable for Listed Companies and Public Limited Company with prescribed threshold limits as to Paid-up Capital and Turnover.

An effort has been made to bring out to list the disclosures which are required to be provided in the Board's report by a **PRIVATE COMPANY** **(whether the said company is a Small Company or not; and OPCs).**

Contents/Disclosures required to be made in the Board's Report:

134 (3) (a) - Extract of the Annual Return as per Section 92 (3) in Form MGT-9:

The major change in the Board's Report under the Companies Act, 2013, in comparison with its counterpart under Companies Act, 1956, is that of inclusion of **Extract of Annual Return,** as an Annexure to the Director's Report.

Rule 12 (1) of the Companies (Management and Administration) Rules, 2014, prescribes the format of the Extract to the Annual Return in **MGT-9.**

The point to be noted here is, under the Companies Act, 1956, normally, the Annual Return was prepared after the completion of the Annual General Meeting, with the details standing as on the AGM Date. However under the Companies Act, 2013, the information standing as on 31.03.2015 (Financial Year end Date) is to be provided in the Annual Return.

Since the extract of Annual Return is to be annexed to the Board's Report, for circulation to all the members, **it is a worth-while point to be noted that the Annual Return should be ready by the time, the Board's Report is being prepared.**

134 (3) (b) - Number of meetings of the Board of Directors:

This disclosure is similar to that of the Listed Companies, pursuant to the listing agreement. The information as to the number of Board meetings held during the Financial year is to be provided, along with the details as to the Directors who attended the said meeting.

The similar information again appears in the Annual Return, so care should be taken as to the giving the said information.

Point to be noted:

All are aware that pursuant to Section 167 (1) (a), the office of a Director is vacated, if the said Director absents himself from all the meetings of the Board of Directors held during a period of 12 months **with or without** seeking leave of absence. So any information provided in the Board's Report or Annual Return, which results in triggering of the provision, may result in the vacation of the office of the said director.

Notice of the Board meetings, Minutes and their attendance during the Financial Year shall have to be verified, so as to see that whether or not, they are in conformity with the requirements under Section 173 of the Act.

134 (3) (c) - Directors' Responsibility Statement:

The Statement under the Directors' Responsibility Statement under Section 134 (3) (c) the Companies Act, 2013, is similar to that under Section 217 (2AA) of the Companies Act, 1956, except for the fact that, **TWO** newstatements have been added which are as below:

*"(e) the directors, in the case of a listed company, had laid down **internal financial controls** to be followed by the company and that such internal financial controls are adequate and were operating effectively.*

*(f) the directors had **devised proper systems** to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively."*

➔ Of both the new inclusions, the statement **(e)** as to **Internal Financial Controls** is required to be provided by a **Listed Company,** but it does not mean that Private Companies are exempted from having internal financial controls, because, **"Internal Financial Controls" (IFCs)** means the policies and procedures adopted by the company for ensuring the orderly and efficient conduct of its business, including adherence to company's policies, the safeguarding of its assets, the prevention and detection of frauds and errors, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information.

From the above, it is clearly evident that **IFCs** are also applicable to Private Limited Companies. The only exemption provided is that the Board of Directors of a Private Limited Company are not required to provide such declaration, as part of their Directors' Responsibility Statement in the Board Report.

➔ Apart from the above, as per statement **(f)** the directors have to give a statement that they had devised proper systems in compliance with the applicable laws and there are operating effectively.

From the above, it can be seen that the above cannot be just statements, and the Director's should kno as to the aspects, as to which they are taking the responsibility by providing this statement in the Board's Report.

134 (3) (ca) -Frauds reported by Auditors pursuant to Section 143 (12):

This disclosure was included vide the Companies (Amendment) Act, 2015 [No.21 of 2015], which came in to effect with effect from26.05.2015. Accordingly, a new sub-clause (ca) has been added after the sub-clause (c) of Sub-section (3) of Section 134, and the provisions of sub-section (12) of Section 143 amended accordingly.

Accordingly, the details of Frauds reported by auditors under sub-section (12) of section 143 other than those which are reportable to the Central Government are to be disclosed in the Director's Report.

Till date, the Central Government is yet to prescribe the limit or amount of fraud involved, of which need to be reported to the Central Government and below which to the Audit Committee or the Board of Directors.

In view of the above, the details of frauds, if any reported by the Auditors to the Company, can be included as part of the Board's Report under this disclosure.

134 (3) (d) - Statement on declaration given by independent directors pursuant to Section 149 (6):

The requirement as to appointment of Independent Director is applicable only for (I) Listed Companies;(ii) the **Public Companies** having **paid up share capital of Rs.10 Crores or more;** or (iii) the **Public Companies** having **turnover of Rs. 100 Crores or more;** or (iv) the **Public Companies** which have, in aggregate, **outstanding loans, debentures and deposits, exceeding Rs. 50 Crores.** [Paid-up capital and Turnover, as on the last date of latest audited financial statements hall be taken into account].

Since a Private Limited Company is not covered under the criteria, it need not appoint Independent Directors on its Board, and accordingly, requirement to give a statement in the Board's Report as to the independence of the Independent Directors is **not applicable to it.**

134 (3) (e) – Constitution of Nomination and Remuneration Committee:

The requirement as to constitution of Nomination and Remuneration Committee of the Board of Directors is applicable only for (i) Listed Companies; (ii) the **Public Companies** having **paid up share capital of Rs. 10 Crores or more;** or (iii) the **Public Companies** having **turnover of Rs.100 Crores or more;** or (iv) the **Public Companies** which have, in aggregate, **outstanding loans, debentures and deposits, exceeding Rs. 50 Crores.** [Paid-up capital and Turnover, as on the last date of latest audited financial statements hall be taken into account]

The responsibility of the Committees is to frame policies on Director's appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under sub-section (3) of section 178;

Since a Private Limited Company is not covered under the criteria, it need not constitute Nomination and Remuneration Committee, and accordingly, the disclosure as to the same is **not applicable** to it.

134 (3) (f) - Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made:

This disclosure is similar to the disclosure under 217(3) of the Companies Act, 1956, except for the fact that, now, in addition to the explanation for the qualifications of the Statutory Auditors,a Company, which has appointed a Secretarial Auditor pursuant to Section 204 of the Companies Act, 2013, needs to give replies in the Board report, for the qualifications, if any, given by the Secretarial Auditor.

However, the requirement as to appointment of a Secretarial Auditor is applicable for **Public Companies** with the following criteria:

➔ having a paid-up share capital of Rs.50 Crores or more; or

➔ having a turnover of Rs.250 Crores or more

As, a Private Company is not covered under the criteria for appointment of Secretarial Auditor, it would be enough that the Board provides replies/explanations for the qualifications/remarks as contained in the report of the Statutory Auditors.

134 (3) (g) - Particulars of loans, guarantees or investments under Section 186:

The details of the Loans granted but the Company, Guarantees or securities provided or Investments made by the Company are to be disclosed in the Board' Report.

It is to note that, for the said disclosure, there is no specific format is provided under the Act and accordingly, a Company may adapt the **Form MBP-2** [being the Register of Loans, Guarantees/Security and Acquisitions made by the Company], and come-up with a format of disclosure.

The information/disclosure is again a check-point, to see whether the loans or guarantees/Securities or investments are with-in the limits of Section 186, and whether approval of the members were obtained for loans/guarantees or investments exceeding the limits.

134 (3) (h) - Particulars of contracts or arrangements with related parties:

Under the Companies Act, 1956, there was no specific disclosure in the Board's Report, as related party transactions, but the same were provided in the financials under AS-18.

Whereas the Companies Act, 2013, has defined the term "Related Party", and Section 188 provides for compliances as to related party transactions.

Rules 8 (2) of the Companies (Accounts) Rules, 2014, prescribes the format of the disclosure as **AOC-2**, to be annexed to the Board's Report.

Accordingly, the details as to **EACH** of the contract or arrangement with the related parties whether done ***(i) at arm's length basis; and/or (ii) not at arm's length basis,*** are to be disclosures in the Board's report.

134 (3) (i) - State of the Company's affairs:

Under this item, the financial position of the Company, i.e., Turnover, Expenditure, Profit before taxes, Profit after taxes, and the surplus transferred to the Balance sheet pertaining to the current year in comparison with the previous year can be given in the form of a simple table.

Further, the future outlook of the Directors, on the business and any other information which the Directors intend to provide, can also be mentioned as a small brief.

134 (3) (j) – Transfer to reserves:

Information as to transfer of profits to reserves, if any, is required to be provided as a disclosure.

134 (3) (k) – Information as to Dividend:

The information as to the dividend proposed to be paid to the members, including interim dividend, declared and paid to the members, and whether the interim dividend already paid is to be considered as final dividend, or any final dividend in addition to the Interim Dividend is proposed to be paid, is to be provided.

In case, the Board of Directors did not recommended any dividend on account on insufficient profits or with an intention to plough back the profits, the same can be mentioned under this disclosure, as a reason for not recommending the dividend for the year.

134 (3) (l) - Material changes and commitments, affecting the financial position of the company:

Any material changes and commitments, which have occurred between the end of the financial year and up to the date of the Report, and which will have a bearing affect on the financial position of the company, needs to be disclosed.

134 (3) (m) - Conservation of Energy, Technology Absorption, Foreign Exchange Earnings and Outgo:

This information is similar to the information provided under Section 217(1) (e) of the Companies Act, 1956 read with the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988.

Rule 8 (3) of the Companies (Accounts) Rules, 2014, lists out the disclosure which are required to be given.

The disclosures as to conservation of Energy, Technology Absorption, Foreign Exchange Earnings and Outgo, under the Companies Act, 1956 and 2013, remain by and large the same, except for one small difference that under Section 217 (1)(e) of the Companies Act, 1956, read with t*he Companies (Disclosure of Particulars in the Report of Board of Directors) Rules,1988,* companies operating in a particular Sectors/Industries, had to disclose details as to Power consumption in the Directors' report, in **Form A** as annexed to the Rules, which is not required under the Companies Act, 2013.

Apart from the disclosure of Power/Energy Conservation, those companies were also required to provide the details as to Research and Development, Technology absorption, adaption and innovation in **Form B** annexed to the Companies (Disclosure of Particulars in the Report of Board of Directors) Rules, 1988, which now under the Companies Act, 2013, is required to be given by all the Companies, subject to the applicability of the said disclosure to them.

134 (3) (n) - Statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, as identified by the Company:

This is a new disclosure to be given, and even made applicable to Private Companies.

The Board of Directors have to identify the risks involved in the business. Risk may be internal risks, external risks.

After the identification of the risks in the operations of the Company, the Board of Directors need to formulate a risk management policy and take steps for implementation of the said Risk Management Policy, and to this effect a disclosure as to the presence and implementation of the said Risk Management Policy, is to be given in the Report of the Board.

134 (3) (o) –Corporate Social Responsibility:

Every company having Net worth of Rs.500 Crores or more, or Turnover of Rs.1,000 Crores or a Net profit of Rs.5 Crores or more during any financial year, is required to constitute a Corporate Social Responsibility Committee, frame a Corporate Responsibility Policy; and is required to spend at least 2 % of the average net profits of the company made during the three immediately preceding financial years, in pursuance of its Corporate Social Responsibility Policy.

Pursuant to Rule 9 of the Companies (Accounts) Rules, 2014, the Company is required to disclose the details as to the constitution of the CSR Committee, and the information as to the CSR activities undertaken as an Annual Report in the format as prescribed under Rule 8 of the Companies (Corporate Social Responsibility Policy) Rules, 2014. The said Annual Report on CSR activities is to be annexed to the Board's Report.

134 (3) (p) – Board Evaluation on its performance:

Since the requirement of constitution of Nomination and Remuneration Committee of the Board of Directors is not applicable to Private Companies, the concept of evaluation of the performance of Board is **not applicable** to them.

OTHER DISCLOSURES AS PER RULES UNDER THE VARIOUS CHAPTERS UNDER THE ACT

Disclosures under Chapter – IV - The Companies (Share Capital and Debentures) Rules, 2014, and rules framed thereunder:

Issue of shares with Differential voting rights:

If the Company had issued shares with differential voting rights during the year, then the details as to the number of Equity shares with differential Voting Rights, details of the differential rights, percentage of shares issued, price at which issued and other details as required pursuant to information pursuant to Rule 4(4) of the Companies (Share Capital and Debentures) Rules, 2014 are to be provided in the Board's Report.

Sweat Equity Shares:

If the Company had issued Sweat Equity shares during the year, the details of the issue as required, pursuant to Rule 8 (13) of The Companies (Share Capital and Debentures) Rules, 2014, are to be provided in the Board's Report.

Employees Stock Options Scheme [ESOPS]:

In case of issue of any ESOPS during the year, the Board's report for the year, shall contain the disclosure/details relating to ESOPS granted, vested, exercised, lapsed and other information, pursuant to Rule 12(9) of the Companies (Share Capital and Debentures) Rules, 2014.

Disclosure under Chapter – IX – The Companies (Accounts) Rules, 2014, and rules framed thereunder:

Information as to Subsidiaries, Associates and Joint Ventures:

Pursuant to Rule 8(1) of the Companies (Accounts) Rules, 2014, the Board's Report of a Company shall contain a separate section, which shall state/report on the performance and financial position of each of the Subsidiaries, Associates and Joint Venture companies included in the Consolidated Financial Statements. Accordingly, the details as to the performance and financial position of each of the Subsidiaries, Associates and JV companies are to be provided in the Board's Report.

Further, all are aware that in case a Company is having a Subsidiary, then in addition to preparation of stand-alone financial statement, the Company is also required prepare a consolidated financial statement of the company and of all the subsidiaries in the same form and manner as that of its own; and the same shall have to be laid before the Annual General Meeting of the company along with the laying of its stand-alone financial statement.

Further, it would not be out of place to mention that for the purpose of preparation of Consolidated Financial Statements [CFS], **the term "Subsidiary", shall include an Associate Company and a Joint Venture.** *However, the Ministry of Corporate Affairs, vide the Companies (Accounts) Amendment Rules, 2014, dated:14.10.2014, had relaxed the requirement as to preparation of CFS in respect of Associate and JV Companies, for the FY 2014 – 2015 i.e., with effect from the FY 2015 – 2016 (01.04.2015 to 31.03.2016), Consolidated Financial Statements are to be prepared even in respect of Associate and JV Companies.*

Disclosure under Chapter – XI – The Companies (Appointment and Qualification of Directors) Rules, 2014:

Changes in the Constitution of the Board:

The information as to the changes in the constitution of the Board i.e., appointment and with specific reference to resignation of Directors [pursuant to Section 168(1)] is to be provided in the Board's Report.

The information/details as to any Directors, who are liable to retire by rotation or any Additional Directors appointed during the year, to be regularised at the AGM, can also be provided under this line item.

Disclosure under Chapter – XIII - The Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, and rules framed thereunder:

Particulars of Employees:

This information is similar to the disclosure under Section 217 (2A) of the Companies Act, 1956, read with the Companies (Particulars of Employees) Rules, 1975 as amended from time to time.

Pursuant to Rule 5 (2) of the Companies (Appointment and Remuneration of Managerial Personnel) Rules, 2014, the particulars of employees employed in India, drawing remuneration in excess of Rs.5 Lakhs per Month or Rs. 60 Lakhs per financial year, as the case may be, are to be provided.

Further it is to be noted that the particulars of employees posted and working in a country outside India, not being directors or their relatives, drawing more than Rs. 60 Lakhs per financial year or Rs. 5 Lakhs per month, as the case may be, is not required to be circulated to the members in the Board's report.

OTHER DISCLOSURES

Acceptance of Deposits:

Since a Private Company is not allowed to accept deposits from the General Public, a disclosure is required to be provided confirming the same. Apart from this, in cases where a Private Company had availed deposits from its members, disclosure as to compliance of the provisions of Section 73 of the Companies Act, 2013 read with the Companies (Acceptance of Deposits) Rules, 2014, is to be provided in the Board's Report.

Details as to Statutory Auditors and Internal Auditors:

Statutory Auditors:

The details as to the appointment of the Statutory Auditors of the Company; recommendation of the Board of Directors to the Members at the ensuing Annual General Meeting to ratify the appointment of Statutory Auditors shall be included in the Board's Report.

In addition to the details of the Statutory Auditors, the Company may also mention the details of the Internal Auditors, appointed, if any, pursuant to the provisions of Section 138 of the Companies Act, 2013 and rules made thereunder.

Disclosure under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013:

Pursuant to Section 22 of the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, every employer(Board of Directors/Company) is required to disclose in their Report i.e., the Board's Report, the details as to the number of harassment complaints which have been received and the status of their disposal.

It is to be noted that this requirement is applicable even if there is one Women employee in the organisation, since there is no specific exemption mentioned anywhere in the Act.

NON-MANDATORY DISCLOSURES

Disclosure under Chapter – XII – The Companies (Meetings of Board and its Powers) Rules, 2014, and rules framed thereunder:

Establishment of Vigil Mechanism:

Pursuant to Rule 7 of the Companies (Meetings of Board and its Powers) Rules, 2014, every company which has borrowed money from banks and public financial institutions in excess of Rs.50 Crores are required to establish a Vigil Mechanism, for the directors and employees of the Company to report their genuine concerns or grievances.

However, there is no mandatory requirement as to informing the presence of the said mechanism in the Board's Report, and it is up to the Board to disclose the same.

SIGNING OF THE BOARD'S REPORT:

The Board's Report along with Annexures if any thereof, shall be signed on behalf of the Board by:

- ➔ the Chairperson of the company where he is authorised by the Board; and where he is not authorised;
- ➔ At least by **Two directors,** one of whom shall be a Managing Director, or by the Director where there is one Director. [In case of OPC and Small Company]

PENALTIES FOR CONTRAVENTION OF THE PROVISIONS - Sec.134 (8)

In case of contravention of the provisions, then:

- ➔ **The Company** shall be punishable with fine which shall not be less than Rs. 50,000/- but which may extend to Rs. 25,00,000/-; and
- ➔ **Every officer who is in default** shall be punishable with imprisonment for a term which may extend to three years or with fine which shall not be less than Rs. 50,000/-but which may extend to Rs. 5,00,000/- or with both.

This article is contributed by CS Phanindra DVK. The author can be reached at phanindra@sbsandco.com

SERVICE TAX

COPYRIGHT – SALE VS DEEMED SALE VS SERVICE

Contributed by CA Harsha & CA Manindar

The taxability of intangibles in the sphere of indirect taxation is often ambiguous and litigation prone. The whole country has witnessed the decision of the apex court in the case of Tata Consultancy Services vs State of Andhra Pradesh[1] wherein it was held that intangible intellectual property right in the computer software is 'goods' and accordingly chargeable to VAT. Post this judgment, the whole perspective of looking at intangibles from the indirect tax point of view has changed and the taxability of such intangibles has gathered complexity leading to huge litigation since the assessee has to face troubles from both the center and state Revenue Authorities.

In the above context, this article tries to understand the implications under service tax and VAT on the copyrights which originate in the process of movie production. Let us try to understand under what circumstances, a producer of the movie is required to pay VAT or service tax when he exploits various rights involved in the movie. Further, let us also try to understand the taxability when a producer chooses to exploit one right among the bundle of rights pertaining to the movie. In order to understand the answers to the above questions raised, it is very important to have basic knowledge about the business of movie productions, origination of the rights therein and their commercial exploitation.

The person engaged in production of cinematographic film is entitled for various rights namely satellite broadcasting rights, video-on-demand rights, Near video-on-demand service rights, video copyrights, DVD copyrights, Broadband rights, Internet rights, terrestrial TV rights, air borne rights, High sea rights, hotel closed circuit rights, theatrical rights, dubbing rights, sub-titling rights, negative rights, re-assignment rights, remake and reproduction rights and animation rights.

The producer of the cinematographic film exploits all or any of the above rights to generate income by transferring all these rights as a whole on permanent or temporary basis. However, in certain arrangements, the producer might transfer (temporary or permanent) one right among the entire rights to one person and the remaining rights to another person. Let us say, the theatrical rights have been transferred (temporary or permanent) to one company and all other rights pertaining to the film are transferred (temporary or permanent) to another company.

The transfer of rights on a permanent basis would mean that the producer relinquishes all the rights in the film to another person for a period and during such period, the producer does not have any rights in such film. Such period may be for perpetuity or say 5 years. Such a transfer is called as permanent transfer. For example, the producer transfers all rights in the film unconditionally and exclusively to another person for a period (5 years or 99 years) and during such period, he does not have any rights in such film. This is the case of permanent transfer.

However, if the producer transfers rights with certain conditions, limitations and reservations, such a transfer is called temporary transfer of such copyright. For example, the producer might transfer distribution rights of a film on a condition that the distribution of such film can be done only for a specific territory. Since such transfer is not an unconditional transfer and not an exclusive one, the transfer results in a temporary mode.

[1] 2004-TIOL-87-SC-CT-LB

Now, that we have understood the mode of business and channels for generation of income for the producer, let us proceed further to understand the indirect tax implication on the same.

Under the indirect tax laws, the mode of transfer (temporary or permanent) is very crucial to determine the taxation of such transaction. On a top level discussion, we can conclude that if the transfer is made on temporary basis, there shall be an obligation under service tax law and if the transfer is made on permanent basis, there shall be an obligation under VAT laws. However, what is interesting to understand is the law involved in arriving such conclusions which is explained in the succeeding paras.

To understand the conclusion that the permanent transfer of rights attracts obligation under VAT, a brief background as to how the VAT laws understand the concept of 'goods' has to be known. The best method we have is to understand the judgment delivered by the apex court in the case of Tata Consultancy (supra), where in it was held that "Goods may be a tangible property or an intangible one. It would become goods provided it has the attributes thereof having regard to (a) its utility; (b) capable of being bought and sold; and (c) capable of transmitted, transferred, delivered, stored and possessed".

Hence, from the above it can be understood that the intangibles which have the above attributes can be regarded as 'goods' and the rights in cinematographic film undoubtedly satisfies all such attributes and hence carefully it can be concluded that such rights are 'goods'.

Once, it is concluded that the rights involved in the cinematographic film are goods, the next question to be answered is whether the transfer of such right to use the goods (rights of cinematographic film) shall be considered as 'sale' under the VAT laws. To answer such a question, the definition of 'sale' as laid down under the VAT laws is crucial and let us see whether the definition of 'sale' under the state VAT laws covers such transfer of right to use the goods under its ambit.

Vide Explanation IV to the definition of 'sale' as provided in Section 2(28) of the Andhra Pradesh Value Added Tax Act, 2005, includes the transfer of right to use goods is deemed to be 'sale[2]' .

Since that it is concluded that the intangibles are 'goods' and transfer of right to use such goods is 'sale', now we will try to understand when the obligation to pay VAT arises. The obligation to pay VAT arises only in a scenario where there is transfer of right to use in goods from one person to another on a permanent basis.

Only in the permanent basis, it can be said that the right to use in the goods is transferred to the other person and in all other modes of transfer, the right to use rests with the seller despite of the fact the possession is with the assignee during such period of transfer. Hence, when the producer transfers the right in the cinematographic film on a permanent basis to another person for a consideration, VAT has to be paid on such consideration.

[2]It is very important to note that deeming the transactions of transfer of right to use goods as 'sale' is resultant of the Article 366(29A) of the constitution which specifically included such transactions in the definition of 'Tax on sale or purchase of goods'.

Once, the mode of transfer of right in the cinematographic film is on permanent basis, there shall not be any implications under the service tax law on such transactions since such transactions which are in the nature of 'Deemed Sales' are specifically excluded from the definition of 'Service' as enumerated in Section 65 B (44) of Finance Act, 1994. Once the said transaction is excluded from the definition of 'Service', there shall be no compliance required under service tax law.

However, if the transfer of rights in cinematographic film is temporary in the nature, then such a transaction attracts compliance under service tax law. The same was made unambiguously clear by the legislature by inserting under the Declared Services vide Section 66E (c), ibid as 'temporary transfer or permitting the use or enjoyment of any intellectual property right'.

So, the question now before us is how to decide a particular transfer to be a temporary or permanent in order to comply under respective laws as described in the above paragraphs. It is not out of context to mention that either under the VAT laws or Service Tax laws, there was mention about how to decide the transfer to be a permanent or temporary. The only test available in this regard is the wisdom laid down by the apex court in the case of BSNL vs. Union Of India[3] . The said judgment lays down five conditions to determine whether the transfer of right to use goods is permanent or temporary. ***<u>If all the conditions laid hereunder are met, then the said transfer is called permanent or otherwise can be concluded as temporary. The said conditions are:</u>***

1. There must be goods available for delivery;
2. There must be consensus ad idem as to the identity of the goods;
3. The transferee should have legal right to use the goods – consequently all legal consequences of such use including any permissions or licenses required thereof should be available to the transferee;
4. For the period during which the transferee has such legal right, it has to be the exclusion to the transferor;
5. Having transferred such right to use the goods during the period for which it is to be transferred, the owner cannot again the same rights to others.

Any agreement entered for transfer of right to use goods (in the instant case, rights of cinematographic film) has to be scrutinized as to satisfaction of the above conditions. If all the above laid down conditions are cumulatively satisfied, then the producer of the film has to pay VAT on the consideration received and if any of the conditions mentioned above are not met, then the producer has to pay service tax on such consideration.

So, the above discussion answers the question as to when the producer of the cinematographic film has to pay VAT or service tax when he exploits the right involved in the film. Now, this leaves us with final question to be answered is what is the taxability when a producer chooses to exploit one right among the bundle of rights pertaining to the movie, which is answered hereunder.

Let us answer the above question by taking an example. Say, a producer of the film, who is the exclusive owner of the film, has 4 different rights emanating from the film. The producer chooses to retain 3 rights with him and exploit 1 right (say satellite rights) by transferring to another person for a consideration. The mode of transfer adopted by the producer is a permanent basis and the terms of the transfer state that the buyer has an exclusive right over the satellite right to the exclusion of the seller. Now, the question that needs to be answered is whether this transaction is subjected to service tax or VAT.

[3] 2006 (002) STR 161 (SC)

From the above discussions, we have learnt that when a transfer of right to use goods is done on a permanent basis, then VAT has to be paid and in all other scenarios, service tax is required to be paid. In the instant example, out of the 4 rights available to the producer, only 1 right is assigned on the permanent basis and the remaining 3 still vests with the producer alone. So, the ambiguity here is whether the permanent basis test is to be applied to all the rights emanating from the film or has to be applied for each individual right.

The consequence of above is, if it is to be applied for all the rights, then the producer in the instant example has to pay service tax on such transaction, since the transfer is not on permanent basis since the 3 rights are still vested with him. If it is to be applied for each right emanating from the film, then VAT has to be paid on the income generated from exploitation of such single right and the same methodology has to be adopted for each and every single right depending upon the mode of transfer.

There is no clarity for the above question in both service tax law and VAT laws. Hence, the resort has to be on the judicial precedents in absence of statutory support. There was a recent judgment by the High Court of Madras in the case of AGS Entertainments Private Limited vs Union of India[4] , wherein the Madras High Court has an occasion to deal with the transfer of copyrights in particular with film industry.

In the said judgment, the High Court has perused various clauses of the agreements pertaining to the transfer of distribution rights and others and concluded that only if the producer transfers all rights pertaining to an intellectual property right that is to say all modes of commercial exploitation then only the said transaction can be called as 'sale' and in all other cases the same can be called as temporary transfer wherein service tax is to be paid. That is to say the permanent basis test has to be applied to all the 4 rights (in the example, we have taken) to conclude about the taxability of the transaction.

However, the facts of the case involved in the above judgment are transfer of distribution rights by the producer to the distributor. The producer has only parted the distribution rights pertaining to specific area and for all other areas the producer has right to distribute the movie. That is to say in the facts of the case involved, the producer has not assigned exclusive distribution rights to the distributor, whereas the facts involved in the example we have taken, the producer has assigned exclusive rights to another person. So, we can conclude that the ratio of the decision of the High Court of Madras cannot be straightly adopted due to the variation in the facts.

Further, the Honorable High Court at one instance has an occasion (vide Para 76 &77) to deal as to what is the tax implication, if the producer relinquishes all the rights pertaining to the copyright vide one mode of exploitation, that is say in that case the producer has assigned exclusive rights for a particular movie to another person for exhibition of such movie through television for the entire world. However, the High Court did not get into detail in respect of taxation of such transaction and has not given any conclusion.

From the above, we understand that if the producer assigns one right emanating from an intellectual property to any other person exclusively (that is to say all the conditions mentioned in the BSNL judgment (supra) are satisfied in respect of such right) then it can be concluded that there shall be no impact of service tax on such right for the reasons mentioned hereunder.

[4] 2013 (32) STR 129 (Mad)

The copyrights in the cinematographic film are bundle of rights. Each right has its own identity and each right involved in the film can be transferred to different persons without affecting other rights involved therein. That is to say, the audio rights involved in a movie can be transferred to one company, the satellite rights to another company and the distribution rights to another company. Each right is independent from other rights and has its own identity and marketability. Hence, the permanent basis test has to be adopted on individual rights and not on the bundle of rights. Since, there are no judicial precedents in the above context, we request the Central Board of Excise and Customs comes up with a clarification before the litigation arises.

This article is Contributed by CA Harsha, Partner at SBS and Company LLP & CA Manindar.
The authors can be reached at harsha@sbsandco.com, manindar@sbsandco.com

FEMA

FOREIGN DIRECT INVESTMENTS IN LIMITED LIABILITY PARTNERSHIP

Contributed by CA Harsha & Vetted by CA Murali |

Limited Liability Partnerships (for brevity referred as 'LLP') is one of the emerging trends among the types of vehicles available for conduct of business or profession. LLP's are governed by Limited Liability Partnership Act, 2008. This article aims at understanding the overview of regulatory requirements when Foreign Direct Investments(for brevity 'FDI') are made in LLP's.

FDIs in LLP's are governed by Notification No 20/2000-RB dated 03.05.2000 (amended from time to time) which deals with The Foreign Exchange Management (Transfer or Issue of Security By a Person Resident Outside India) Regulations, 2000. As per Regulation 5(9) of the said regulations, any person resident outside India (other than a citizen of Pakistan and Bangladesh) or any entity incorporated outside India (other than entity in Pakistan or Bangladesh) and not being specified persons[1] may contribute foreign capital either by way of capital contribution or by way of acquisition/transfer of profit shares in the capital structure of LLP under FDI, subject to the terms and conditions mentioned in Schedule 9 of the said Notification.

Schedule 9 lays down the scheme for acquisition/transfer by a person resident outside India of capital contribution or profit share of LLP. As per the said scheme, FDI is allowed in fresh or existing LLP, where 100% FDI is allowed into the Company registered under Companies Act, under the automatic route of FDI scheme. That is to say where FDI is allowed in the sectors which have a restriction on investment or 100% with approval of regulators or FDI-linked performance related conditions, investments in such sectors where LLPs are operating, is not allowed. The sector where 100% of FDI is allowed under automatic route is provided in Annexure B to Schedule 1 of the subject notification.

However, FDI in LLP, where 100% is allowed under automatic route as per subject notification, requires prior approval of Government/Foreign Investment Promotion Board (for brevity referred as 'FIPB') as per Entry 4 of the said schedule. There is no specified format for seeking approval from FIPB. An application on the letter head of the LLP explaining the background of the activities and details of the investor has to be provided to FIPB for approval. Further, LLP should also register on www.fipb.gov.in and submit an online application along with the required documents.

It is very important to note that Indian companies (which are having FDI) intending to invest in LLP (downstream investment), is subject to all the conditions listed herein above and shall obtain prior approval of FIPB by adopting the same methodology described above. Further, such LLP and investor company should operate in such sectors where 100% FDI is allowed vide automatic route.
However, LLP which is in receipt of FDI under the said scheme cannot further make any downstream investment in any entity in India.

The company with FDI can be converted into LLP only if the stipulations mentioned in Schedule 9 are met and with the prior approval of FIPB.

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[1]Specified persons means a registered Foreign Institutional Investor or Foreign Venture Capital Investor or Qualified Foreign Investor registered with SEBI or Foreign Portfolio investor registered in accordance with SEBI guidelines

On receipt of approval from FIPB and on receipt of consideration towards capital contribution or acquisition of profit share in LLP has to be reported with 30 days from such receipt to Regional Office concerned of the Reserve Bank in Form Foreign Direct Investment – LLP (I). The report shall be acknowledged by the Regional Office and will be allotted with a Unique Identification Number (UIN) for the amount reported. Further, any disinvestment/transfer of capital contribution or profit share between resident and non-resident (vice-versa) is required to be reported to Regional Office concerned of the Reserve Bank in Form Foreign Direct Investment – LLP (II) within 60 days of such transaction.

Another important condition in case of Company acting as Designated Partner of an LLP with FDI, such LLP can have only company registered in India as designated partners and no other body corporates (LLP or Trust) shall be allowed. Such designated partner or nominee thereof shall satisfy the conditions applicable for "Person Resident in India" as defined under the FEMA. The designated partners or nominees of such designated partners shall be responsible for compliance with all the conditions mentioned in the scheme and also liable for all the penalties imposed on LLP for their contraventions.

In case of any non-compliance of the regulations related to receipt of FDI, they have to approach FIPB for post factoapproval and liable for penalties under FEMA or can opt for compounding procedure.

This article is contributed by CA Harsha & Vetted by CA Murali, Partners at SBS and Company LLP.
The authors can be reached at harsha@sbsandco.com, gmk@sbsandco.com

INCOME TAX

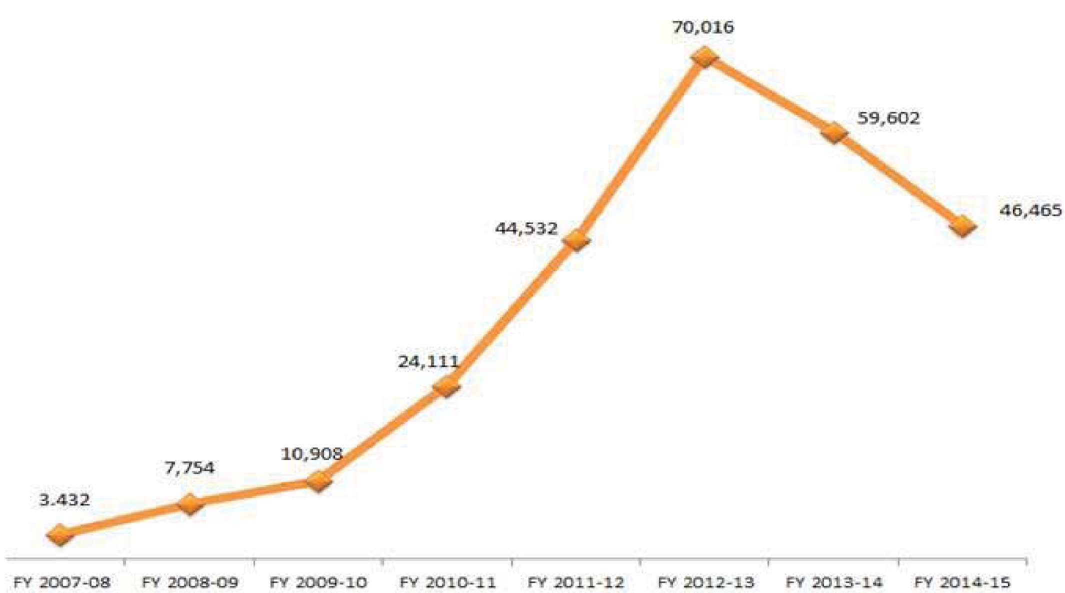
INDIAN TRANSFER PRICING ('TP') – CHANGING TRENDS

Contributed by CA Mithilesh

The TP Regulations in India were introduced in 2001 under the anti-abuse provisions of the Income-tax Act, 1961 (ITA) largely modelled on the TP principles followed by the organisation for Economic Cooperation and development (OECD) and aimed to ensure that transactions between group companies adhere to the arm's length standard. Initially, the TP law was applicable only to cross border transactions between group companies (referred to as Associated Enterprises or AEs) and now has been expanded to specified domestic transactions to. Chapter X deals with Transfer Pricing Regulations (TPR) with sec 92 to 92F of ITA. The rules for interpretation and implementation of the provisions are Rule 10A to 10E of the Income Tax rules, 1962 ('Rules').

India as a TP jurisdiction has positioned itself in a reckonable manner in the global tax scenario. Over the past 8 years, while the basic framework has remained the same, the law has seen substantial changes- some applying retrospectively. In the decade that passed since the introduction of TP regime in India, the country has seen a significant tax disputes and litigation surrounding TP issues reflecting growing aggressiveness on part of the tax authorities to plug purported erosion of tax base. Not surprising, in many global tax surveys, India is often recognized as a country having a very challenging TP regime.

In the recently concluded the TP audits, the Indian tax authorities continued with their rigorous enforcement and new issues continue to emerge such as allocation of location savings, investment in share capital, marketing intangibles etc. There is a sustained surge in the quantum of transfer pricing adjustments spanning many industries like information Technology, Automotive, Pharmaceuticals and Finance & Insurance, as evident from the statistics in the table below(INR Crore – Thousands):



Source: Annual Report issued by the Ministry of Finance (FY 2014-15 & FY 2013-14)
(Using conversion rates as on 31st March of respective years)

While the Indian Government has been responsive to the taxpayer grievances on growing TP disputes and has initiated a number of steps to resolve TP Disputes (such as introduction of alternative resolution mechanism, APA, safe harbours, clarification on identification of contract development centres etc), the same have not yet yielded results. Further, the failure of the Government to bring in detailed guidance in the implementation of Indian TP regulations, has exacerbated the situation. Some of the recent development in TP in India has been discussed below briefly:

1. Safe Harbour Rules:

Safe Harbour rules were announced with a view to reduce the number of TP audits and prolonged litigation on TP disputes in India. The CBDT has notified the safe harbour rules based on Rangachary committee recommendations. The safe harbour rules are applicable for 5 years starting from the year of application.

The safe harbours prescribed for the assessee's engaged in rendering the prescribed International Transaction are as follows:

International Transaction	Turnover limit/Loan limit/Guarantee amount	Safe harbour rate/margin
Software development and IT enabled services (Net Operating margin as a percentage of Operating Cost)	< INR 5 billion >INR 5 billion	20% 22%
Knowledge process outsourcing services and contract R&D services wholly or partly relating to software development (Net Operating margin as a percentage of Operating Cost)	NA	25%
Intra-group loans (The safe harbour is what can be added to the base rate of State Bank of India)	<INR 500 million >INR 500 million	Interest rate 150 basis points 300 basis points
Corporate guarantee (Percentage of commission is calculated on amount guaranteed)	<INR 1000 million >INR 1000 million	Commission 2% p.a 1.75% p.a
Contract R&D services wholly or partly relating to software development	NA	30%
Contract R&D services wholly or partly relating to generic pharmaceutical drugs	NA	29%
Manufacture and export of core auto components	NA	12%
Manufacture and export of non-core auto components	NA	8.5%

Definitions for eligible assessee with insignificant risk, eligible international transactions, Operating expenses & Operating cost have been prescribed under the rules.

If the assessing officer is of the opinion that the assesse is ineligible for the safe harbour option, then he would refer the matter to the TPO. Assesse can appeal to the Commissioner against such action of the assessing officer.

Where a taxpayer's transfer price is accepted by the tax authority under the safe harbour rules, the taxpayer is not entitled to invoke Mutual Agreement Procedure ('MAP') under an applicable tax treaty.

2. Advance Pricing Agreement (APA):

TP has emerged a key area of litigation in the recent years. The cost, lengthy processes, and inevitable uncertainty make litigation an undesirable alternative for taxpayers and governments.

The Finance Act 2012 introduced provisions to enable Advance Pricing Agreements (APAs) in the ITA with effect from 1 July 2012 the rules for implementing APAs were notified. The Rules enable a taxpayer to file an application for a unilateral, bilateral or a multilateral APA. The Rules contain procedures for APA applications, information, data, and forms that need to be filed, circumstances under which the Board may discontinue an APA and compliance procedures for monitoring a concluded APA.

The introduction of APAs is expected to provide an alternative remedy to resolve TP disputes in advance. The success of APA programs in many countries offers a significant opportunity for the Indian tax administration to resolve international TP issues mutually in advance.

As a first step for initiating the APA process, a taxpayer is required to undertake a pre-filing consultation, which canalso be requested on an anonymous basis, before a formal APA application is submitted.
The taxpayers' AE is expected to initiate an APA process with the Competent Authority (CA) in the other country in case a bilateral or multilateral APA is envisaged.

The Rules provide for an application fee which could be INR 1 to 2 million depending upon the value of the international transactions entered into or proposed to be entered into during the proposed period of the APA.

The APA mechanism is broadly as follows:

- ✶ The taxpayer can approach the Board for determination of the arm's length price(ALP) in relation to an international transaction that may be entered into bythe taxpayer.
- ✶ The ALP in an APA is determined using any method including the prescribed methods, with necessary adjustments or variations.
- ✶ The ALP determined under the APA deemed to be the ALP for the international transaction with respect to which the APA has been entered into.

- ✶ The APA is binding on both the taxpayer and the tax authorities as long as there are no changes in law or facts that served as the basis for the APA.

- ✶ The APA is valid for the period specified in the APA subject to a maximum period of 5 consecutive financial years.

- ✶ Rollback option has been also provided in the recent FA 2015 and with which the taxpayers can opt for a rollback of APA and hence the taxpayers can opt for a litigation free Five years going forward and four years backward (totally 9 years) from the date of signing the application.

3. India's new Company Law - Arm's length concept for Related Party Transactions (RPT):

With the new Companies Actseeking arm's length concept for dealing with RPTs, companies need to assess whether their RPTs comply with the arm's length principle and thereafter evaluate their compliance and reporting obligation under company law. The scope of RPTs under the Companies Act ismuch wider in scope than the TP provisions.

While the Companies Act does not provide any guidance for determining the manner in which thearm's length principle would need to be applied, companies may find it useful to refer to the manner in which the principle is applied under the Income Tax Act to test whether the transactions are in accordance with thearm's length principle.

4. Specified Domestic TP:

The Finance Act 2012 has extended the scope of TP provisions to specified domestic transactions based on the suggestion made by the Apex Court in the case of Glaxo smithkline Asia Pvt Ltd. The intent is to curb tax arbitrage possible in cases where companies tend to shift profits from one tax paying entity to another tax exempt or loss making entity within India. (Threshold limit for applicability of SDT Provisions is the value of the transactions (consolidated) till FY 2014-15 is 5 Crores and from FY 15-16 the threshold limit has been extended to 20 Crores).

As per the provisions, the following domestic transactions would be under the purview of the Indian TPR:

- ► Payments to related parties;

- ► Inter-unit/ inter-company transactions that impact tax holiday profits;

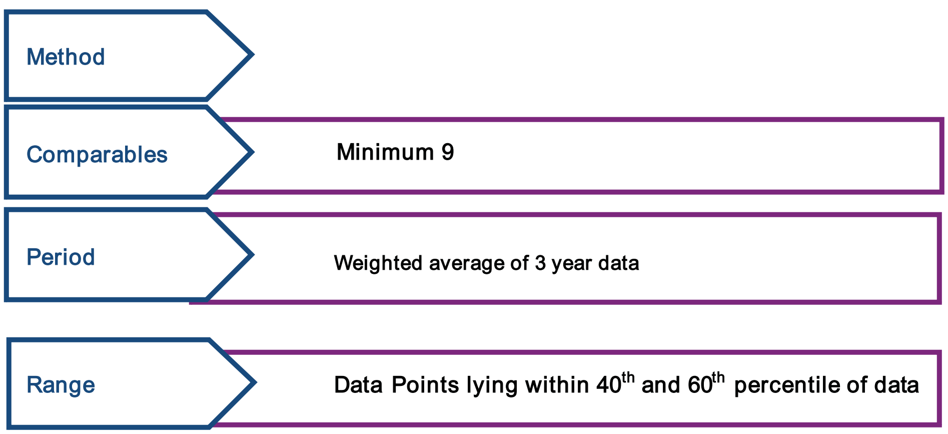
- ► Other transactions as may be specified;

5. Revision in Tolerance range calculation and usage of multiple year data:

- In Budget 2014, the finance minister has made an announcement that 'range concept' (where there are adequate number of comparables and usage of multiple year data, for determination of ALP, would be introduced;

- The finance Act, 2014 has introduced a proviso to section 92C(2) of the Act, that provides for ALP determination in relation to a international transaction or SDT undertaken on or after April 1, 2014. (i.e. from Assessment Year 2015-16), ALP shall be computed in such manner as may be prescribed.

- The CBDT on May 21, 2015, announced draft rules on the application of range concept and use of multiple year data.



If the transfer price of the tested party falls outside the range computed, the 'median' of the range would be taken as ALP and adjustment to transfer price shall be made.

Arithmetic mean under the following scenarios:

- In cases where "range" concept does not apply, the arithmetic mean concept shall continue to apply along with benefit of tolerance range ;

- In cases where multiple year data is to be used, the same would apply whether "range" concept is used or arithmetic mean is used for determining the ALP.

6. Conclusion

Taxpayers in India find themselves in a challenging position of documenting and defending their transfer pricing as transfer pricing controversies continue to rise. In view of the current trend of transfer pricing in India, it is crucial for taxpayers to strengthen their transfer pricing policies as well as the documentation to support them, explore and evaluate risk mitigation strategies and alternate mechanisms with regard to already concluded transactions and future transactions

This article is contributed by CA Mithilesh. The author can be reached at mithilesh@sbsandco.com

BASIC PRACTICES

SIGNIFICANCE OF RAPPORT BUILDING WITH CLIENTS

Contributed by CA Sandeep |

It is important to develop good working relationships with clients to ensure effective audit engagement.

To be a successful auditor it is essential to build rapport with the audit client. There are several approaches and techniques related to rapport building. Auditors can adopt certain means in the course of their work to build a strong rapport with the client which will assist in maximizing the success of the audit function. The approaches include knowledge of client business, acting proactively, active listening, problem solving skills and a partnering approach to the relationships.

Knowledge of client business

To gain deep insight of the client business and processes it is very essential to review prior audit work papers including financial statements, understanding key performance metrics, trends for the area being reviewed. In depth understanding of the laws and regulations are all means to demonstrate an understanding of the business. An auditor who demonstrates their understanding of client business or processes that is being audited is often respected by the clients. For the areas of any uncertainty, auditors should consider discussing any questions with client management team.

Acting Proactively

Advance planning, proactive communication and advanced scheduling of meetings, arriving to meetings on time and keeping to scheduled time and agenda items thus demonstrate respect for client time, hence will provide an opportunity to auditors to build rapport with the clients. Additionally, auditors should confirm their information requirement list is comprehensive to minimise any back and forth communication with the client. At the commencement of the engagement the auditor shall identify and understand the client's communication preferences. The auditor should evaluate the form of communication to ensure it is the most effective method of communication to obtain necessary communication.

Active listening

Active listening play a vital role to increase rapport with the client, auditors should approach the meetings, interviews, and other interaction with the goal of active listening. Various obstacles to listening can prevent auditors from truly understanding the message being conveyed by the client. If needed the auditor should consider paraphrasing what has been said by the client to the client to ensure an accurate understanding of process and information relayed.

Problem solving skills

Engagements shall be approached by the auditors not only keeping in mind about the external and internal environment of the business and its unit but also with the motive to analyse the information gathered, including any exceptions identified to determine the who, why, where, when, what and how behind the information. This approach may assist auditor to identify risks that were not considered in prior audits. Close interactions with the client would help to recognize the most appropriate solutions for any risks that are uncovered thereby maximizing the audit effectiveness.

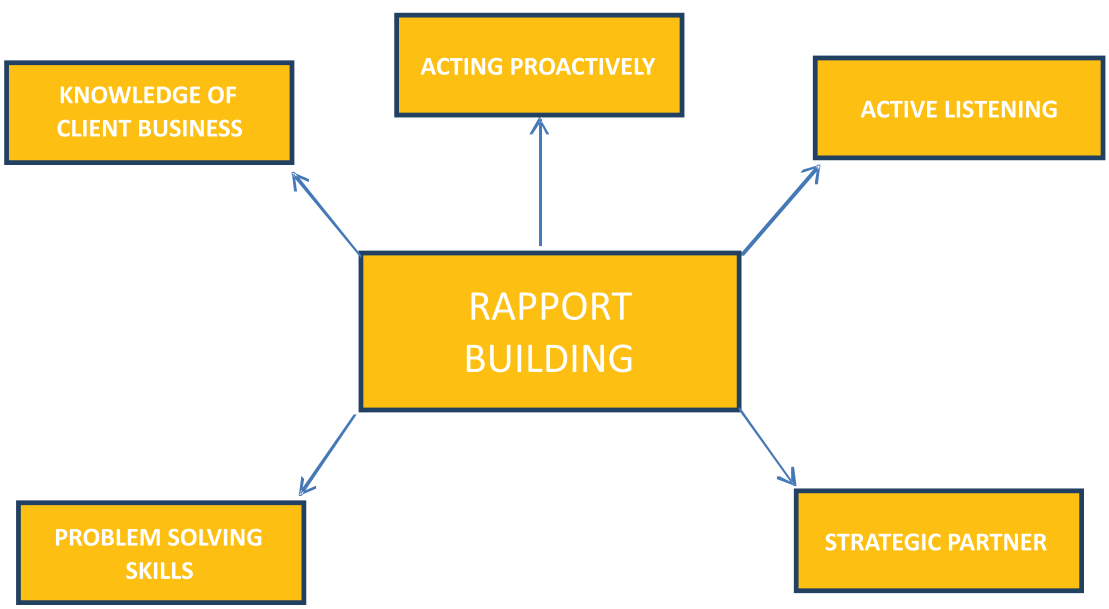
Strategic partner

Auditors have an opportunity to build rapport with and gain respect from, their clients by developing a partnering approach to the relationship. This include working closely with the client to truly understand the root causes behind any issue identified and working recommendations that not only address the root cause but also consider the associated benefits and costs. This can incorporate reporting to senior management best practices client has implemented within its organization and sharing best practices that the auditor has seen within other operating units.

Impact of rapport building

Developing good working relationship with the client not only make the day – to-day audit process more enjoyable for the auditor and the client, it also lead to a more successful audit function that will add value to the clients. Always look at the long term, not the short term with clients. Building trust is the key so that clients talk openly and we become their trusted advisor.

FUNDAMENTALS OF RAPPORT BUILDING



This article is contributed by CA Sandeep. The author can be reached at sandeepd@sbsandco.com

TECHNICAL SESSIONS:

S.No.	Event	Date	Speaker	Venue
1	Road Map for implementing IFRS in India	11/09/2015	CA Aruna	SBS - Hyd
2	Over view of Project Finance	18/09/2015	CA Rajesh	SBS - Hyd
3	Filing of Service Tax Returns	25/09/2015	CA Manindar& CA Harsha Vardhan	SBS - Hyd
4	SAP Business One ERP for Small and Medium Enterprise	09/10/2015	Madhu Sudhan Reddy (VESTRICS SOLUTIONS - DIRECTOR)	SBS - Hyd

Note:

The timings for the above events shall be from 17:30 hrs to 19:30 hrs. We request the recipients of "SBS Wiki" who are interested to attend the above events to send confirmation of your participation 2 days in advance to make appropriate arrangements an d sharing of the relevant material, if any.

Export expemption benefits - CA Manindar

Preparation of Financial statements using MS Office - CA Saran Kumar U

Basics in Project finance - CA Rajesh

Swachh Marg - 4K Walk by SICASA - Team SBS Participation

Hyderabad: 6-3-900/6-9, #103 & 104, Veeru Castle, Durganagar Colony, Panjagutta, Hyderabad, Telangana
Kurnool: No. 302, 3rd Floor, V V Complex, 40/838, R.S. Road, Near SBI Main Branch, Kurnool, Andhra Pradesh
Nellore: 16-6-259, 1st Floor, Near Santi Sweets Opp: SBI ATM, Vijayamahal Centre, SPSR Nellore, Andhra Pradesh
Tada: 8-3-425/2, Flat No. 202, 2nd Floor, Bigsun Avenue, Near SRICITY, TADA, SPSR Nellore Dist, Andhra Pradesh
Visakhapatnam: # 39-20-40/6, Flat No.7, Sai Yasoda Apartments, Madhavadhara,Visakhapatnam (Urban),Vizag, Andhra Pradesh

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