Nanubhai Desai & Co.

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the RECKONER

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Introduction

Nanubhai Desai & Co (ND&Co) is a well recognised firm of Chartered Accountants providing wide range of consultancy and advisory services in India. ND&Co, with convergence of professionals and vast knowledge & experience, offers high quality and specialized services in the fields of Indian & International taxation, Accounting & Auditing and Regulations governing inbound & outbound investments.

ì The Reckonerî by ND&Co is an initiative to enhance the service level for our esteemed clients and professional contacts. This e-publication shall offer, on regular basis, updates in the fields of Taxation, Accounting & Auditing and Regulations governing inbound & outbound investments in India. The Indian regulatory and legal environment is quite dynamic, especially on the tax front. Various tax appellate authorities & the governing authority (viz. the Central Board of Direct Taxes) often announce far reaching changes/clarifications on the prevailing direct tax law and its interpretation. Similarly, the other two important regulating authorities governing investments in/from India (viz. the Securities Exchange Board of India ñ SEBI & the Reserve Bank of India ñ RBI) regularly update/amend relevant regulations, by issuance of notifications, guidelines, amendments, circulars, etc., which would affect the method and manner of investments in/from India. The Institute of Chartered Accountants of India (ICAI) & Department of Company Affairs pronounce various statements which would alter/affect the norms of accounting/auditing the select economic transactions/activities. In such a dynamic and ever changing environment, it is essential to keep abreast with the recent developments & its likely impact on your business. ND&Co, through this The Reckoner, would help you achieve this.

ND&Co is elated to share its comprehensive & unique knowledge bank resource in the form of this monthly e ñ publication with its most revered clients and professional contacts. We look forward to our continued mutually beneficial association. We promise our sincere commitment to help you be the best in the professional arena. We would be glad to have your comments/feedback at admin@nanubhaidesai.com .

Contents

INCOME TAX

Domestic Taxation

Amendments via circulars, notification, etc

1. The Cost of Inflation Index (CII) that is considered for the purpose of computation of Long Term Capital Gains has been notified by the CBDT for current financial year to end on 31/3/2009 to be ì582î. The Cost Inflation Index for the last financial year was ì551î.

2. Central Board of Direct Taxes has notified that Professional Services as described in section 194 J shall include sports activities of Sports Persons, Umpires and Referees, Coaches and Trainers, Team Physicians and Physiotherapists, Event Managers, Commentators, Anchors, and Sports Columnists.

Case Laws

1. Penalty under section 271(1) (c)

Gold coin Health Food Pvt. Ltd. [Supreme Court]

As per section 271 (1) (c), the assessing officer has wide powers to levy penalty on the assessee if in the opinion of the assessing officer, the assessee has concealed the particulars of his income or has furnished inaccurate particulars of such income. The provision of the said section was amended with effect from 1 March 2003 to clarify that the assessing officer would not be permitted to levy the penalty if the income declared by the assessee for the relevant year was in negative.

However, in this landmark case, which will have impact on many tax payers, Honorable Supreme Court held that the assessing officer can levy penalty even if the returned income by the tax payer was a loss.

Supreme Court held that relevant provision of section 271 (1) (c) is merely clarificatory and not substantive. Thus, the word ëincomeí should be interpreted to include both positive as well as negative income. As far as the retrospectivity of the same is concerned, the Supreme Court was of the view that in absence of a retrospective operation having been expressly given, the courts may be called upon to construe the provisions and answer the question whether the legislature had sufficiently expressed that intention giving the statute retrospectivity. Therefore, as per the decision, the amendment relating to penalty under the amended provision in case of loss return has retrospective effect.

International Taxation

General

1. OECD Model Convention

On 17 July 2008, the OECD Council approved the contents of the 2008 Update to the OECD Model Tax Convention. The update includes number of changes and additions that have been made to the observations, reservations and positions of member and non-member countries. India was also invited to present its position on the OECD Model and its commentary. Consequently, the 2008 Update also includes India's positions/ reservations (as a non-OECD member) on commentaries of various Articles of the Convention. The same are summarised below.

1. **Treaty privilege to tax transparent entities**
   - OECD Commentary suggests that treaty benefits should be granted to the members of the tax transparent entities, where such entities are deprived of such benefits.
   - India, however, is of the view that this will only be possible if specific clauses to this effect are included in the concerned Treaty.

2. **Place of Effective Management (POEM) for determining residence**
   - In case of an entity which has a dual residency status, OECD Commentary proposes that the POEM (a determinant factor for residential status) shall mean the place where key management/commercial decisions are in substance made, which are necessary for the conduct of the entityís business as a whole.
   - In Indiaís view, this interpretation of POEM is rather limited & should also include place where the main and substantial activities of the entity are carried on.

3. **Fixed Place PE**
   - India does not agree with OECDís stance on existence of geographical & commercial coherence, as a necessary factor for a Fixed place PE.
   - OECD Commentary suggests that mere leasing of tangible/intangible property without maintaining a place for undertaking the said activity in the source country does not constitute a Fixed Place PE. However, India has a contrary view on the above.
   - As regard to determine a subsidiary as a PE, Indiaís position is that where a group company manufactures goods or provides services for or on behalf of a foreign enterprise, the first mentioned company could constitute a PE if the other requirements of the definition are also satisfied.

4. Agency PE

- OECDís position on Agency PE is that mere attending or participating in the negotiations by itself, does not reckon an authority to conclude contracts.
- Nonetheless, India opines that in certain circumstances, mere participation is sufficient for the conclusion that the person has exercised authority to conclude contracts.

5. Service PE

- Prior to this update, the commentary had no specific rule on PE creation on account of furnishing of services. The concept of service PE & guidance thereon has now been included in this update.
- India has made some reservations on the following issues
  - ✓ For furnishing services in a country, physical presence of an individual is not essential.
  - ✓ Taxing rights may exist even when services are performed from outside the source country by a non resident.
  - ✓ Tax amount can also be computed on the amount of gross fees paid for such services, rather than calculating tax amount only on the profits derived, as suggested by OECD.

6. Business Profits

- India has made reservations for amending Article 7 of a Tax Treaty relating to 'Business profits' to provide that profits attributable to a PE in India would be taxable, even if the payments are deferred until the PE has ceased to exist in India.
- India has also made reservations regarding its right to add a paragraph in its bilateral treaties with other countries to the effect that the business deductions outlined in a tax treaty would be subject to limitations under the domestic tax law.
- OECD commentary suggests that a formula based approach to determine profits attributable to a PE in a source country should be discontinued. However, India does not agree with this stance.

7. Taxation of Royalties

- OECD Model Convention 2008 Update includes clarifications on issues relating to classification of intangible transactions for the purpose of royalties.
- However, India has expressed its reservations, regarding OECDís interpretation & classification of intangible transactions. India is of the opinion that some payments may constitute as royalties. For instance, payments done for right to use industrial, scientific or commercial equipment may give rise to income in the nature of royalties.
- India has also expressed its reservation regarding the taxability of fees for technical services, that it should be taxed on a source basis.

2. Vodafone Tax Controversy

Hutchison Telecommunications International invited bids from several investors for auctioning its investments in a Cayman Island Company. Indian Income Tax authorities sought requisite information from Vodafone (UK) with regard to the purchase of shares, by its group company based at Netherlands, of this Cayman Island Company owned by Hutchison, Hong Kong. The Cayman Island Company owned shares of a Mauritian Company which had invested into the shares of an Indian telecom company. Vodafone challenged this action of Indian tax authorities and sought to obtain injunction over the said action by filing a writ petition with Bombay High court. As per the press reports, the potential tax demand from the share purchase transaction could be US$ 2 billion!!

The recent tax controversy over Vodafone case is a classic example of art of interpretation of laws. As per the press reports, counsels of Vodafone & the tax department have overwhelmingly argued the matter. The entire fraternity of tax professionals & tax officers are eagerly awaiting the judgement of Bombay High court on this matter which is expected to be passed in a near future. Irrespective of the decision of the Honourable Bombay High Court, in this case it might be certain that the case would be referred to Supreme Court for a final say in such matter.

3. DTAAs signed by India in 2008-09

The Government of India has signed 74 tax treaties. India has, in current fiscal year, signed Double Taxation Avoidance Agreements (DTAAs) with few countries. The table below lists the countries with whom India has signed DTAAs, during the financial year 2008-09.

Countries with which India signed the Treaty	Date of Signing	Withholding tax rates who entered Royalties (R) Fees for technical services (FTS), for Dividend (D)
Luxemburg	2nd June 2008	D& R&FTS = Not exceeding 10 per cent
Myanmar	3rd April 2008	D = Not exceeding 5 per cent R = Not exceeding 10 per cent

In addition to the above, India has also entered into a DTAA with Tajikistan in the financial year 2008-09.

Case laws

1. SET Satellite (Singapore) PTE Ltd. Case (Bombay High Court)

Background & Facts

- The assessee, SET Satellite (Singapore) PTE Ltd. is a company incorporated in Singapore, having a dependant agency (DA) in India [SET India Pvt Ltd] for performance of activities of marketing of ad- space in India on behalf of the assessee for a commission. The nature of activities performed by the DA in India on behalf of the assessee gave rise to the existence of a dependant agency permanent establishment (DAPE) in India.
- SET India Pvt. Ltd. paid taxes in India on the commission earned by it from the assessee. However, the assessee did not pay any tax on the advertising revenue that it sourced from India on ground that it was carrying on the activity through a dependant agent, to whom the payments were made at armís length basis.
- The assessee relied to the Circular no. 23 of 1969, issued by the CBDT, stating that the taxability of income arising out of a transaction, where services are performed through a commission agent in India, will be limited to the profits attributable to the agentsí service. Also, the assessee referred to the decision of the Supreme Court in the case of Morgan Stanley & Co., Inc (292 ITR 416), which held that if an associated enterprise, being a PE, is rewarded on armís length basis, then nothing further can be attributed to the foreign enterprise. Thus, the assessee contended that where the DA is remunerated on armís length basis, nothing further remains to be taxed for the DAPE in India
- However, the Revenue did not agree to this view and the appellate authority (viz. the Income Tax Tribunal) decided the matter against the assessee. The appeal was therefore filed by the assessee before the Bombay High Court. The Revenue also referred certain matters for the consideration by the Bombay High Court.

Decision & Conclusion

- The Court referred to the submissions and arguments placed by both the parties, viz. the assessee & the Revenue. The Court also referred to Circular no. 23 of 1969 issued by the CBDT.
- The Court agreed to the contention of the assessee that the ratio laid down by the Supreme Court in the case of Morgan Stanley & Co., Inc (292 ITR 416), would be pertinent.
- The Court held that in all circumstance, the payment of an armsí length compensation to the DA, should fully extinguish the profits attributable to the DAPE.

2. Hindustan Aeronautics Ltd. Case (ITAT Bangalore Bench)

Background & Facts

- Hindustan Aeronautics Ltd. (herein after referred to as 'HAL'), a public sector undertaking of Govt. of India, has 16 production units and 9 Research and Design Centres spread over seven different locations in India. Its product track record consists of 12 types of aircraft from in-house Research & Development (R&D) and 14 types by way of licensed production. HAL's supplies/services are mainly to Indian Defence Services, Coast Guard and Border Security Force.
- M/s Rosoborn Export State Corporation, a sole state intermediary agency for research military exports in Russia, is associated with major arms deliveries within the framework of Russia's military technical co-operation with foreign countries.
- HAL entered into a contract with M/s Rosoborn Export for carrying out R&D (development, manufacture and testing of the AL-551 engine for Indian HJT - 36 trainer aircraft).
- HAL has remitted Rs. 261 millions to Rosoborn Export State Corporation for its R&D for two years. The Assessing Officer concluded that the services rendered by M/s Rosoborn Export fall in the category of 'technical services' as per the Income-tax Act as well as per DTAA with Russia.
- On the basis of such conclusion, he passed the order that the amounts paid are held as fees for technical services in India as per the provision of Article 12 of DTAA read with sec. 9(1) (vii) of the Income-tax Act and HAL is required to deduct tax in terms of provisions of section 195 (1).
- Thus, the AO treated HAL as defaulter in terms of provision of sec. 201(1). The assessee was also charged interest in terms of provision of sec. 201 (1A). The total tax and interest to the asst. year 2006-07 and 2007-08 comes to the tune of Rs.3, 04, 26,157/-. The, learned CIT (A) also confirmed the order of the AO.

Decision & Conclusion

- The Bangalore tribunal had examined the contract and the requirement of HAL to enter the contract and take the necessary testing services of M/s Rosoborn Export. From the entire reading of the contract, it is seen that the requirement of the assessee was only for 3 prototype engine AL-551.
- On reading of the relevant article of contract one cannot see that the requirement of the assessee was the technical know how of the engine from M/s Rosoborn Export to reproduce or copy or to develop the same in future. In the circumstance, it cannot be presumed that payment made to the foreign company, M/s Rosoborn Export, was fee for technical services for the purposes of explanation 2 to section. 9(1) (vii).
- The tribunal held that the payment made to the foreign company, M/s Rosoborn Export, was payment for the engine and not fee for technical services. According to tribunal if foreign company, M/s Rosoborn Export,

delivered any technical know how along with 3 prototypes engine AL-551; it cannot be considered as having rendered technical services to the assessee.

- Thus, the payment made to M/s Rosoborn Export as consideration cannot be taken as fee for technical services. Hence, the payment made by the assessee was not fee for technical services for want of explanation 2 to section. 9(1)(vii) and so the assessee is not required to be charged tax for the payment made to M/s. Rosoborn export.

3. ACIT v. Paradigm Geophysical Pvt. Ltd (ITAT Delhi Bench)

Background & Facts

- The assessee, Paradigm Geophysical Pvt. Ltd., a foreign company registered & managed at Australia was proficient in providing analytical services to oil exploration / processing companies.
- The assessee entered into two contracts with an Indian company, one for providing 2D/3D processing of seismic data relevant for oil prospecting / exploration & another for providing technical guidance and training of clientís personnel on usage of its proprietary software tools exclusively used in oil exploration to achieve quality levels compliant with global standards in the industry.
- The assessee contended that the revenue receipts under the first contract would not be taxable as Fees for Technical Services (FTS) under the Income tax Act (The Act) or as royalty under Article 12(3) (g) of the India Australia tax treaty (the treaty). However, the Revenue disagreed on the above & took a contrary position. As far as the second contract is concerned, the assessee offered the receipts to be taxable under section 44 BB of the Act; whereas the Revenue opined that the same should be taxed as per the provisions of the treaty.
- The questions raised before the tribunal were ñ
    a. Whether revenue earned by the assessee for providing services of processing data outside India, even though the same were utilized in India, be taxable as fees for technical services (FTS) under the Act/ the treaty?
    b. Whether technical guidance & training, provided for the use of software, be taxable under section 44 BB of the Act?

Decision & Conclusion

The decision of the Tribunal with reference to the above questions raised is as under ñ

- With regard to the receipts arising from the first contract, revenue earned from services of processing of data was taxable as FTS under section 9(1) (vii) (b) of the Act.
- However, the same would not be chargeable to tax under Article 12 of the tax treaty. Also, it would escape taxability in India vide Article 7 of the treaty, as the assessee did not have PE in India.

- As far as the second contract is concerned, the Tribunal held that technical services rendered by the assessee, shall be held as taxable under section 44 BB of the Act, as such services were rendered in connection with the prospecting for, or extraction or production of, mineral oil.

4. Sojitz Corporation v. ADIT (ITAT Kolkata Bench)

Background & Facts

- The assessee is a Japanese company having a liaison office in India, established as per the approval granted by the RBI, for the purpose of collecting information and sending the same to the head office at Japan which are preparatory and auxiliary in nature/character.
- The revenue contended that the liaison offices maintained by the Japanese company should be treated as its PE in India.

Decision & Conclusion

- When the liaison offices are not indulging in any other activity other than collecting information and sending the same to its head office outside India, then such liaison offices cannot be treated as PE of the foreign company in India.

- The liaison office of the Japanese company provides information/ services to the office at Japan which are preparatory and auxiliary in nature/character, as per the approval granted by the RBI, the liaison office cannot be treated as PE of the non-resident assessee in India.

5. LG Cable Ltd. v Dy. DIT [ITAT Delhi]

Background & Facts

- The assessee, LG Cable Ltd., is a tax resident of Korea, having a project office in India with the due approval of RBI. The assessee entered into two contracts with an Indian company (Power Grid Corporation of India Limited (PGCIL)), one relating to offshore supply of equipments (offshore contract) & other related to onshore installation, erection & commissioning activities.
- All the services concerning the onshore contract were rendered by their project office in India & resulting in the project office as a fixed place of business of the company in India. This would give rise to existence of Permanent Establishment (PE) of the Korean company in India. Having regard to the provision of article (5) of Indian Korean DTAA. Thus, the assessee offered the onshore contract income for tax in India while filing the return of income in India.
- However, it did not offer for tax, the income arising from the offshore contract, on the ground that all the activities like supply of goods, payment of sale consideration, documentation, etc. were carried on outside India.

- The assessee also referred to the decision of the Supreme Court in the case of Ishikawajima Harima Heavy Industries Ltd. (288 ITR 408) wherein it was held that income from offshore supplies are not taxable in India.
- However, the Revenue was of the opinion that income from both the contracts should be taxable in India, as they were not independent contracts & that the PE was responsible for the supply of the equipment. Also, the revenue argued that neither the property in goods was transferred in Korea nor the total price was paid outside India, as the erection of the equipment was done in India.

Decision & Conclusion

The Tribunal referred to the contents of the agreement entered by the assessee with the Indian company & also considered the submissions made by the assessee & the revenue authorities. On the facts of the case, the tribunal also concluded that the ratio laid down by the decision of Supreme Court in the case of Ishikawajima Harima Heavy Industries Ltd. (288 ITR 408) shall be applicable in this case as well.

The Tribunal therefore decided the matter in favour of the assessee. While arriving at this decision, the tribunal made the following observations:-

- The activities under the onshore and the offshore contracts were separate and distinct and could not be clubbed together. There was separate consideration for obligations to be discharged under the onshore contract.
- Mere signing of the contract in India cannot be a determination factor for ascertaining the place of accrual of income, especially when the PE had no role to play for supply of equipment in India.
- Although entire consideration was not paid on shipment of equipment, it cannot prevent the transfer of property to the purchaser, as the assessee had received the irrevocable Letter of Credit for the same.

6. M/s Geoconsult ZT GMBH – Advance Ruling

Background & Facts

- Geoconsult ZT GMBH is an Austrian company, providing project consultancy services. It formed a Joint Venture (JV) with two Indian companies, for providing project consultancy services for a contract conferred upon it by Himachal Pradesh Road and Infrastructure Development Corporation Ltd. ('HPRIDC') for the development of tunnels.
- For the purpose of this JV, it sought a ruling from the AAR, for the status of its taxability as per the Income Tax Act.
- On thorough examination of the terms of contract as well as service agreement of the JV, the Revenue asserted that the JV has all the elements of an Association of Person (AOP), i.e., common purpose, common action and the object to produce income or profit.
- However, the applicant contended that it cannot be taxed as an AOP, as the purpose for this JV was ease of execution. Also they had well defined

& identified scope of work, separate billing & bank accounts and principally, there was no arrangement to share profit between the ventures, as they were directly paid their share of revenue.

Ruling by the AAR

- The AAR ruled that the JV partners had ëassociatedí themselves with a ëcommon designí to provide consultancy services for the development of tunnels.
- The service agreement between JV & HPRIDC clearly sets out the intention for the JV, i.e., common purpose for doing the task & also earning revenue. Also the agreement reveals that venturers are jointly & severally liable to HPRIDC, with the joint responsibility of completing the assignment, implying common management and planned coordination among the venturers.
- As far as the revenue sharing is concerned, the terms of the contract revealed individual payment, the bills would be consolidated by the applicant to make an invoice.

Thus, if a JV has the following essential elements, then it shall be construed as an AOP should be taxed accordingly.

- ✓ Two or more persons
- ✓ Voluntary combination
- ✓ A common purpose or common action
- ✓ Combination in joint enterprise
- ✓ Some kind of scheme for common management

In view of the above rationale, the AAR ruled that this JV should be taxed as an AOP.

7. Airports Authority of India – Advance Ruling

Background & Facts

- The applicant, Airports Authority of India (AAI) has sought ruling of the AAR, on the tax liability of the foreign company, Raytheon (US resident company), so as to assess its responsibility towards withholding taxes. Raytheon entered into a contract with AAI for a supply of customised software & hardware, installation & training services in connection with such software & hardware and also grant of a non exclusive & non transferable license to use the software in Delhi and Mumbai region.
- The applicant contended that consideration received by Raytheon was business profits and not taxable in India due to the absence of any PE of Raytheon in India.

Ruling by the AAR

- The AAR observed that Raytheon has not transferred ownership in the documents and software supplied to AAI, but Raytheon has only given the right to use them for the purpose and in the manner provided in the contract. It is significant to note that AAI has been given the non-exclusive right of use and it has no right of sale, public distribution and circulation of the computer programme delivered to it.

- The AAR ruled that consideration paid for the right to use copyright in the customized computer software, is royalty & is taxable as per the Act as well as India - US DTAA.
- The consideration paid in connection with installation, testing and training, will be taxable as Fees for technical services (FTS)

REGULATIONS GOVERNING INVESTMENTS

Amendment to pricing of QIPs

The market regulator SEBI on 13 August 2008 amended the pricing norms governing Qualified Institutional Placements ("QIP").According to the investment bankers; this will result in a wave of private placement issues in the coming months.

The amendment in the pricing norms is seen as a big step to change the future to align the pricing of the specified securities with the prevailing market price.

The revision in pricing is as follows

- Period under consideration, for calculation of the price is now reduced to the average price of two weeks prior to the relevant date, against the earlier requirement of taking the higher of the previous six months' or 15 days' average price.
- The term "relevant date" now stands amended to the date on which the board of the company, or the committee of directors duly authorized by the board of the company, meets to take the decision to open a QIP.

The precariousness displayed by the capital market over the recent months, coupled with the clear disparity between the prices calculated in accordance with the erstwhile pricing formula may have contributed to the slowdown in investments into India. The change would also give a chance to the Indian company to optimally price the QIP since the price of the same is to be determined in accordance with the date of the board meeting (i.e. the relevant date).

The change in calculation of pricing by the regulator will give a thrust to potential investors. It is will be a boon to Indian companies which wish to raise capital from the market, by being able to offer a more competitive price to investors. The Ministry of Finance has also proposed certain changes in the pricing method of ADRs & GDRs, even though the amendment is anticipated. While it is expected that the reforms introduced will bring in a rush of investments, the reaction of investors is something to look out for.

Amendment to FEMA regulations (Bank Accounts)

Foreign Exchange Management Regulations, 2000, have been amended to allow foreign companies, having project offices in India, to open two bank accounts ñ one in home currency & another in US dollar. Priorly, they were allowed to open only one account with Banks (in home currency). This additional account will be subject to the same terms and conditions as applicable to the existing foreign currency account provided that both the foreign currency accounts are maintained with the same AD Category ñ I bank.

Proposal to raise Equity holding limit in stock exchanges

The Securities & Exchange Board of India (SEBI) is examining a proposal to raise the limit for single investors in stock exchanges from 5 % to 15 %, applicable for single investors, both local & foreign. In the demutualisation scheme approved for Stock Exchanges, wherein the public was to have 51% stake - as opposed to 49% for broker-owners who owned the exchange earlier - the regulator had put a 5% limit on the stake a single investor could acquire. Now, it proposes to increase this limit to 15 %.

Press Not no. 9 – Downline Investment may require permission of FIPB

Foreign Investment Promotion Board (FIPB) vide press note no. 9 has taken steps to liberalise the investment regime for foreign companies and enable foreign-owned Indian holding companies make downline investments under the automatic route, subject to the fulfilment of certain conditions. The regulatory view of FIPB is that in the event an operating company in which there does exist FDI and such operating company further makes a downline investment or acquisition, the character of the company changes from being an operating to an operating-cum-holding company. For making a downline investment, the company shall require a prior permission of FIPB.

Most operating companies having FDI, as a plan of their business growth, promote subsidiary companies for carrying out different business activities or acquires other companies who is carrying out such business activities in which FDI is either not permissible for 100 percent or FDI is not permissible at all. These operating companies were making investment in such companies either through internal accruals or through proceeds from FDI to fund downline investment.

FIPB vide the press note no. 9 refers to the aspect of foreign-owned holding companies. However, the term ì ownedî has not been defined by a threshold, and the percentage of foreign investment to infer ì ownershipî has not been made explicit. It can be presumed that the intention of the FDI policy is for the term ì foreign-owned holding companyî to mean a 100% investment.

ACCOUNTS & AUDIT

IFRS 1: 1st time adoption

The ICAI has already announced the transition date of 2011 for adoption of IFRS. This date actually means 2010, since comparables would be required under IFRS. The Ministry of Corporate Affairs has also made its intention to adopt/converge to IFRS. Few Companies have already started preparing for conversion to IFRS, however many companies are still laboring under the illusion that IFRS are not much different from Indian GAAP or that date of transition is still very far.

IFRS 1: First Time Adoption

IFRS 1 states that, if an entity so chooses, it need not restate the business combinations that have taken place prior to the opening balance sheet date.
Converting from local GAAP to a new accounting framework can be quite an onerous task. The most critical aspect is to restate the opening balance sheet as if the new accounting framework was always followed. This can make things very difficult. Residual values are not revised on an ongoing basis under Indian GAAP but are required under IFRS. Capitalization of exchange differences was allowed under Indian GAAP but not under IFRS; and Component accounting followed under IFRS but not under Indian GAAP.

Exemptions allowed

Fortunately, IFRS 1 First Time Adoption of IFRS allows certain exemptions such as in the case of fixed assets, these could be fairly valued as of the opening balance sheet date (date of transition) and the same would constitute a deemed cost under IFRS. Once the fixed asset value is plugged as of the opening date, going ahead, all the requirements of IFRS would need to be complied with.

IFRS 1 also allows exemptions in regards to accounting of business combinations. This is important in the Indian context, since business combinations are accounted at historical cost under Indian GAAP, whereas under IFRS business combinations are accounted for on the basis of fair valuation principles. Under IFRS 1, if an entity so chooses, it need not restate the business combinations that have taken place prior to the opening balance sheet date. However, business combinations after that date are to be accounted for in accordance with IFRS.

In the case of employee share-based payments, under Indian GAAP, both **the intrinsic method** and **the fair-value method** are allowed. Under IFRS, employee share-based payments are required to be accounted for using the fair value method.

While IFRS provides exemptions, in a few cases, it also prohibits retrospective application of IFRSs. Such is evident in the case of hedge accounting, at the date of transition an entity shall measure all derivatives at fair value and; eliminate all deferred losses and gains arising on derivatives that were reported under previous GAAP, as if they were assets or liabilities.

Through numerous exemptions and a few exceptions, IFRS 1, makes it practical for a converting company, to change from Indian GAAP to IFRS. Other than the exemptions and exceptions, an entity shall in its opening balance sheet recognize all assets and liabilities whose recognition is required under IFRSs and not recognize items as assets and liabilities, if IFRSs do not permit such recognition. It is recommended that Indian entities start preparing themselves for converting to IFRS. As a first step, they may consider performing a diagnostic to identify high level differences between the two GAAPs to be followed by a detailed implementation strategy. It may be noted that adoption of IFRS will not only have accounting implications, but will have significant business consequences as well. Consequently, those that approach IFRS adoption as a mere technical exercise will not be able to fully optimize on the benefits of adopting IFRS.

ICAI issues 4 new standards for enhancing the level of internal checks

The Institute of Chartered Accountants of India (ICAI) has issued four new standards during August 2008, to help companies to streamline internal audits, for minimizing pilferage, ensuring cost efficiency and mitigating waste. These standards are in addition to the existing 3 standards for internal audit, dealing with analytical procedures, sampling, reporting and quality assurance in internal audit. These Standards will standardize the process of internal checks in companies. Now onwards companies can expect that professionals engaged in internal audit functions, shall render services of such standards as being issued by the Institute.

The council of ICAI has also issued an Auditing & Assurance Standard (AAS) concerning with securing representation from the management by the auditor. This will bring about a harmony with international norms as prescribed by International Auditing and Assurance Standard Board (IAASB) in this regards.