LALIT BAJAJ & ASSOCIATES

Connection

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DECEMBER 2012

JUST TO REMIND YOU:

- Dec 7 - Payment of TDS
- Dec 15 - E Payment of PF for Nov
- Dec 15 - Filing e forms 23AC & 23ACA (XBRL)
- Dec 25 - E Return of VAT for Nov

INSIDE THIS ISSUE:

Reverse Mortgage 3

CTS 4

Exchange Traded Funds 5

e-Passbook Service 6

FDI 7

Online Registration of CAs on New e-filing website 8

Due Diligence Review

Due diligence review can be defined as critical analysis of a potential target prior to making a business decision such as corporate merger, acquisition, investment or similar corporate finance transaction, normally by a buyer.

The purpose of the due diligence review is to provide decision-makers with reliable and necessary background information on the proposed business transaction. The purpose for the due diligence review is specific, known and well defined in advance.

Buy-Side vs. Sell-side Due diligence

As mentioned, due diligence review is generally instigated by the buyer or theinvestor to undertake critical analysis of the business of Seller or Investeeentity or the 'Target'. This is referred as 'Buy-side due diligence'.

At times, particularly in auction situations, due diligence may also be instigated by the Seller, Investee entity or the 'Vendor', so as to provide potential investors / bidders with an independent in-depth assessment of the Seller's business. This is called 'Vendor due diligence'. Vendor due diligence reports are generally prepared to provide identical information to all potential investors / bidders and facilitate faster closure of the transaction

Types of due diligence reviews:

As the current business environment involves multiplicity of functions, a corporate transaction

requires inputs on each of these key business functions. There are various types of due diligence reviews that provide the necessary information to decision makers for making an informed decision. These include:

- Commercial due diligence – This review provides inputs on external commercial factors impacting the target's business such as industry growth and its nuances, competition, market share, potential opportunities and threats.
- Operational due diligence – Operational reviews focus on various operating aspects of the business such as operational efficiency, Human Resources, Environmental matters, Information Technology, etc.
- Financial and accounting duediligence – This review provides necessary inputs regarding quality of earnings (i.e. revenue growth, pricing sensitivity, cost and margin trends), quality of assets (i.e. investment adequacy and recoverability of current assets), completeness of liabilities, robustness of financial systems and accounting practices, etc.
- Tax due diligence – Tax diligence provides insights into the tax assessments, pending litigations, eligibility (or otherwise) of incentives and exemptions, etc. The review, at times, also suggests an efficient tax structure for the transaction.
- Legal due diligence – Legal diligence review provides insights into status of target's regulatory and legal compliances, other legal relationships with its customers, franchisees / principals, suppliers, bankers and employees, etc. For a due diligence to be effective, it is important that the review not only provides insights into the historical functioning of the target entity, but also to highlight potential /

expected outcomes and expected implications of the transaction.

Undertaking a Due Diligence review

Chartered Accountants (CAs) are well placed to undertake Financial and accounting due diligence and Tax due diligence review due to their professional expertise and experience. CAs may also undertake Commercial due diligence reviews with some experience in the field. However, it is important to note that undertakinga a due diligence review require a specialized approach and a different mind-set, given the fundamental differences between an audit and a due diligence review.

Reporting Due diligence findings

Due diligence findings may be broadly classified under the following 4 categories:

- Rationale or Strategic matters –These matters refer to diligence findings that impact the basic premise or the foundation of the transaction. For example: In case a transaction is undertaken for backward integration i.e. to acquire raw materials and based on the information available and procedures performed, there are issues regarding suitability or adequacy of raw material, contradictory to the earlier belief. Any such matter may or may not have immediate solution. Hence these matters may materially impact transaction structure or may also result in cancellation of the transaction.
- Pricing or negotiation matters – Any finding that provides scope of repricing or negotiating better terms for the transaction needs to be highlighted. Some examples of pricing matters include are (i) lower expected growth or margins as against the business plan submitted for the transaction. (ii) unfavorable or restrictive terms under customer / vendor contracts not earlier disclosed or factored in the plan (iii) Unfunded / unprovided liabilities (iv) Sub standards asset quality, say unrecoverable debtors, deferred repairs on fixed assets, etc. Any Pricing or negotiating matter, if material enough, may also become a Strategic issue, if it challenges the basic premise of the transaction.
- Protection and structuring matters – There may be certain observations that require buyer to seek protection in the Transaction documents (Investment Agreement). Some examples include (i) Usage of common facilities / brands / IPR with other Vendor entities (ii) Indemnity against past taxation or litigations (iii) Continued availability of raw materials from Vendor entities at pre-defined terms, etc.
- Next steps – Matters that require steps to resolve / dispel potential issues, either pre-closure or post closure of the transactions are generally classified under Next Steps. Some of these Next Step matters include (i) Obtaining necessary governmental approvals say, FIPB (ii) Technical assessments of IPR related assets (iii) Process to be followed for efficient tax structuring of the transaction.

CAs and Due diligence review

Given the heightened level of corporate transactions, be it Merger & Acquisition (M&A) or private equity / strategic investments there is a growing market for due diligence services. Further, as per the existing statutory provisions in India, CAs may provide due diligence services to its audit clients. Thus, the specialized due diligence services have become an important avenue for profitably enhancing our service offerings.

Reverse Mortgage

What is Reverse mortgage and how does it operate?

It is a type of mortgage in which an owner of a residential property in Indian can borrow money against the value of his or her home. A reverse mortgage provides stream of income flows which normally senior citizens can tap into for their retirement. Borrower need not have any income nor is his credit record relevant as the loan is being secured by the underlying property.

Under the reverse mortgage, borrower will have various options to receive the loan, either lump-sum, monthly payments or a line of credit. Amount received not considered as income chargeable to tax since the loan advances are disbursement of the principal and not income. No repayment of the mortgage (principal or interest) is required until the borrower dies or the home is sold. The loan amount can either be repaid by the borrower, his/her legal heirs.

All one needs to ensure to avail a reverse mortgage loan is to have an own house with no encumbrances.

Tax breaks for reverse mortgages

The reverse mortgage scheme has been announced in budget 2007 with a view to provide a stream of cash flow to needy senior citizens against mortgage of their residential house. There were areas of confusions which were addressed subsequently in the Finance act, 2008 where in the following two amendments were made effective FY 2007-08 which cleared off all the confusions:

- Though mortgage of property under transfer of property act is treated as transfer, a new provision has been made under section 47(xvi) of the income tax act to provide that any transfer of capital asset in a transaction under notified reverse mortgage scheme will not be treated as transfer and shall not attract any taxable capital gains.
- A new provision u/s 10(43) of the income tax act has been introduced to clarify that any amount of loan, received either in lump sum or installments under a notified reverse mortgage scheme shall be treated as exempt from income tax.

Further, the Central Government has also notified 'Reverse mortgage scheme, 2008' vide notification No. 93/2008 dated 30-09-2008. As per the notification, the reverse mortgage benefits can be availed by an individual who is 60 years or above as on the date of application for loan to the approved financial institutions. Such an eligible person has to apply for the loan under this scheme in writing to the approved financial institution. Only thing he/she needs to ensure is that the residential house property is located in India and it is free from any encumbrances.

Loan eligibility

The approved financial institution being any scheduled bank of housing finance company may disburse the loan to the reverse mortgagor by any one of the following modes namely.

- Periodic payments to be decided mutually between the institution and the reverse mortgagor.
- Lump sum payment in one of more tranches, to the extent that the aggregate of the amount disbursed as lump sum does not exceed fifty percent of the total loan amount sanctioned.

The loan so granted under reverse mortgage shall not be for a period of more than 20 years from the date of signing the agreement by the reverse mortgagor and the approved financial institution. The reverse mortgagor, or his legal heirs or estate, shall be liable for repayment of the principal amount of loan with interest to the approved lending institution at the time of foreclosure of the loan agreement.

Cheque Truncation System (CTS)

"Coming January 1, 2013, banks will not accept cheques that do not confirm to the new standards under the CTS"

CTS-2010 is a benchmark for standardization of cheques issued by banks across the country. The main feature of CTS-2010 cheques is that a cheque can be cleared electronically.

Simply put, a CTS-2010 cheque will not have to go through the process of physical clearance. When a customer deposits a CTS-2010-complied cheque, the bank can simply send the cheque's image to the drawee bank, whose cheque has been issued; once the drawee bank scrutinizes and recognizes the cheque, it will get cleared. This move will help banks save on transaction cost and time.

Features

CTS-2010 cheques will have security features such as a certain type of paper, CTS watermark, bank's logo in invisible ink and a standard field placement for all banks.

- **Paper:** CTS-2010 standard paper doesn't glow under ultra-violet light. The paper will be image friendly and have protection against alterations by having chemical sensitivity to acids, alkalis, bleaches and solvents giving a visible result after a fraudulent attack.
- **Watermark:** All CTS-2010 cheques will carry a standardized watermark with the words "CTS INDIA", which can be seen when the cheque is held against a light source. The watermark will appear at the centre of the cheque.
- **Bank's logo:** The bank's logo will be printed in ultraviolet (UV) ink. The logo will be visible under UV-enabled scanners or lamps. The banks logo has to be on the left top of the cheque.
- **Prohibition on corrections on cheques:** Any kind of changes or corrections will not be acceptable.

Under the new system, only scanned images of cheques will be required for clearances. This substantially cuts down the delay suffered due to clearing processes and will bring operation efficiency.

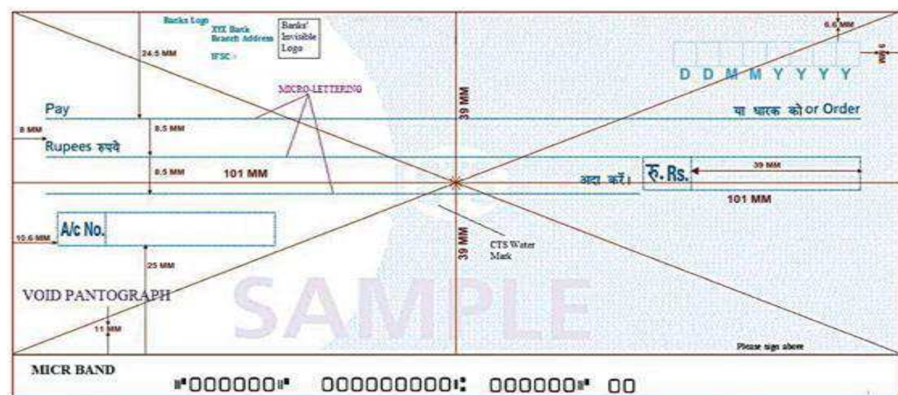
The homogeneity in security features acts as a deterrent against frauds and the fixed placement specifications felicitate straight-through-processing at drawee banks' end through the use of image character recognition technology.

The Reserve Bank of India (RBI) has advised all banks to issue only CTS-2010 (cheque truncation system-2010) standard cheque. The initiative has been taken to standardize and enhance security features in cheque forms.

Starting January 1, 2013, banks will not accept cheques that do not conform to the new standards under the Cheque Truncation System (CTS).

India's largest lender, the State Bank of India (SBI) said it has issued a public notice requesting all its branches to start issuing cheques with CTS-2010 standardized features. The bank also requested its customers to surrender non-CTS cheques.

RBI directed banks to ensure replacement of non-CTS post dated cheques that may have been held for Equated Monthly Installments before December 31, 2012. While most private banks have migrated to the new system, public sector banks are in the process to do so.



EPFO launches e-Passbook Service

Over 50 million PF subscribers can now access their accounts online as retirement fund body EPFO launched its e-Passbook service. Active subscribers whose electronic challan-cum-return is already uploaded, can download their e-Passbook every month under this service.

The facility shall be available on www.Epfindia.Gov.In.

In the case of members who are not active (left service) and have not settled their account or have not become inoperative, the facility to download the passbook on request basis shall be available.

Any member of Employees Provident Fund Organisation (EPFO) can register on the member portal by using his or her photo identification number, such as PAN, Aadhaar, National Population Registry, driving licence, passport, voter ID, ration card and use the mobile number as password.

Members can add multiple ID (identification) numbers after registration and can use any one for logging into their account. Once registered, a member can download the passbook by entering his or her account number. If available, the passbook will appear for download.

The e-Passbook shall contain the transaction-wise details of the member's account (all credits and debits) since the month for which the details for the establishment have been processed in new application software at the field offices.

The facility, however, will not be available for members under exempted establishments under the EPF Scheme 1952 (as the fund details are maintained by the Trust) and inoperative members (i.e. in accounts where no contribution has been received in the preceding 36 months).

Under the e-Passbook service, only one registration will be allowed against one mobile number, and a member can download the passbook for only one account number under one establishment.

Rule 2BA not mandatory to claim deduction u/s 35DDA for VRS

It is clear from the proviso to section 10(10C) that in order to claim an exemption under this section in respect of any payments received/receivable by an employee under any voluntary retirement scheme/ schemes, such scheme/ schemes must comply with the guidelines prescribed in this regard i.e. guidelines prescribed under Rule 2BA. In other words, the employee is entitled to exemption under section 10(10C) of the Act only if the voluntary retirement scheme fully complies with the conditions as prescribed in Rule 2BA. There are no such provisions in section 35DDA of the Act similar to proviso to section 10(10C), so as to include the conditionalities of Rule 2BA into section 35DDA of the Act. A plain reading of provisions of section 35DDA of the Act, it is clear that compliance with the conditions of Rule 2BA is mandatory only to avail exemption under section 10(10C) of the Act by the employees and thus the said rule is not relevant to deduction under section 35DDA of the Act.

Foreign Direct Investment (FDI) in Various Sectors

"Implementation of this policy will facilitate greater FDI inflows into front & back-end infrastructure"

As per extant FDI policy, FDI, up to 26% is permitted, in the defence sector, with prior Government approval. Government has, further, interalia announced the following decisions:-

- Amendment of certain conditions relating to FDI, up to 100%, in single brand retail trading, vide Press Note No. 4(2012 Series) dated 20.9.2012
- Permitting FDI, up to 51%, in multi-brand retail trading, subject to specified conditions, vide Press Note No. 5 (2012 Series) dated 20.9.2012
- Permitting foreign airlines to invest, in the capital of Indian companies, operating scheduled and non-scheduled air transport services, up to the limit of 49% of their paid-up capital, vide Press Note No.6 (2012 Series) dated 20.9.2012
- Permitting FDI, up to 49%, in power exchanges, vide Press Note No. 8 (2012 Series) dated 20.9.2012

The above mentioned decisions have been incorporated in the Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2000 vide Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) (Sixth Amendment) Regulations, 2012 notified in the Gazette of India: Extraordinary vide G.S.R.795(E) dated 19.10.2012.

It is the Government's assessment that implementation of the policy is likely to facilitate greater FDI inflows into front and back-end infrastructure; technologies and efficiencies to unlock the potential of the agricultural value chain; additional and quality employment; and global best practices. This, in turn, is expected to benefit consumers and farmers in the long run, in terms of quality and price. The 30% mandatory sourcing condition has been incorporated to encourage local value addition and manufacturing. The increased level of activity, in the front-end, as well as in the back-end, resulting from greater FDI inflows, is expected to create additional employment opportunities for rural and urban youth. It is, further, expected to encourage existing traders and retail outlets to upgrade and become more efficient, thereby providing better services to consumers and better remuneration to the producers from whom they source their products.

The consultations with key stakeholders regarding FDI in multi-brand retail trading brought out views both for and against FDI in multi brand retail trading. On balance, however, the discussions generally indicated support for the policy, subject to the introduction of adequate safeguards. The necessary safeguards have, accordingly, been incorporated in the policy and are expected to protect the interests of various stakeholders. Government has also decided to constitute a high-level group to make recommendations on internal trade reforms, with a view to ensuring distributional efficiencies and also that the benefits from trade are available to all sections of society.

Lalit Bajaj & Associates

Knowledge to Fight… Confidence to Win

Office No: 32, Nityanand Nagar III,
25/27 S. N. Road, Near Railway Station,
Andheri (East), Mumbai - 400069
Phone: +91 - 22 - 26845133

Office No: 5, Barsana,
Salasar Brij Bhoomi,
Near Maxus Mall,
Bhayander (West), Thane - 401105
Phone: +91 - 22 - 28180400
Fax: +91 - 22 - 28040048
E-mail: admin@bajajit.com

Exercise Your Right By Casting Your Vote…

Dates: Dec 7 at Mumbai, Pune, Ahmedabad
Dec 8 at Mumbai, Pune, Ahmedabad & Other Places
Time: 8.00 a.m. to 8.00 p.m.

Registration of CAs in New e-filing Website

The new e-filing system launched by the CBDT (Central Board of Direct Taxes) has opened a window for chartered accountants to register and upload certain specified reports required to be furnished by chartered accountants including tax audit report. Time and again, ICAI has pursued the issue of misuse of membership numbers being followed at various levels. The same has been well appreciated by the Department, which now requires the Chartered accountants to directly upload their reports with their digital signatures in the e–filing website. The assessee is, however, required to mention the details of the chartered accountant while filing his return. ICAI would also be validating the data of practicing members for the purpose of registration and thereafter at the time of filing of report. This will ensure that no fake audits are being reported to the Department.

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