

The Articled....

Because u'r Altitude is determined by u'r Attitude

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SICASA REGIONAL CONFERENCE, 2007

Every Speakers Platform has been prequalified for service, quality and professionalism. The world has become competitive. An individual is recognized only when he is sound in his knowledge and courageous to convey his knowledge to others. It's only a sound speaker who can mark his name and can be known to be "The Best". The Southern Indian Chartered Accountants Students Association had given an opportunity to the newly budding Chartered Accountants to participate in the conference conducted in the month of November 2007 which was themed 20:20. It conveyed the message of teamwork, leading to the success of an individual by improving the communication skills of the students of Chartered Accountancy. The Chairman of SICASA, SIRC of ICAI, CA P.R.Suresh said that 20:20 is the typical winning combination of youth, exuberance, enthusiasm, nonchalance, spirit, zeal and quest for success with a vision for leadership and excellence.



DNS too grabbed this opportunity. The Conference was held on 24th and 25th of November, 2007 at Chennai and mainly focused on the most debatable topics in the field of Chartered Accountancy like Futures & Options, IFRS, GST, Transfer pricing etc.

The Conference laid a podium for the students to speak out their minds in the most expressive way. Our fellow article 'Shilpa Patawari' took a step ahead to speak on the most important and happening topic of Accounting Standards, AS- 28 "Impairment of Assets". It was a group of 11 who accompanied her to Chennai, for knowledge gaining and also to be a part of her motivation. Her lucid vocabulary and her approach to the subject is a part of her successful presentation. She was also appreciated as a professional & crisp speaker by the dignitaries. She was given a memento and a certificate for her active participation.

We congratulate Ms. Shilpa Patawari for representing our firm and for actively participating in the conference. We wish her all success for her future. We hope her participation has built in a confidence and has motivated others to come forward to lay the foundation as sound speakers.

"A real achiever is a person who builds his foundation, by the bricks thrown at him by others". The road to success is incomplete without criticism and its very easy to succumb to it than to take it on a positive note.

If taken positively, it can bring out the best in us by making us realise our capabilities. More often than not, the strongest edifices have criticism as their corner stone

It is indeed a great pleasure to know that a small step taken for the enhancement of knowledge internally has succeeded immensely in imparting and delivering information and critical updates to the masses as well.

This opportunity is ample for us to thank all our readers for sending in their comments and views for the continued improvement of "The Articled".

Editorial

Thoughts:

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Demystifying Service Tax on Goods Transport by Road

- By Abhishek, Supriya, Sumana, Vinay A, Shashank

Synopsis: In the year 1997 Service Tax was imposed on services provided by Goods Transport Operators by road. However due to stiff opposition by Truck operators and owners, the levy was abolished. Under Rule 2(1)(d) specified persons who pay the freight (service receiver) were made liable to pay tax. There were notifications issued restricting persons liable to pay tax, granting total exemption and then canceling the exemption. However from 01.01.2005 the levy was brought back on service provided by Goods Transport Agency, whereby the consignor/ consignee was made liable to Service Tax.

As provided by the definition the following condition should be fulfilled to be termed as 'Goods transport agency':

- The agency can be any person.
 - The service should be provided in relation to transport of goods by road.
 - The agency must issue a consignment note.
- The Budget Speech on 08-07-2004 by the Finance minister it was mentioned that services provided by Goods transport agency was liable to Service tax.

- Thus all sort of services provided by road are not liable to tax.
- Only GTA which issues a consignment note is liable to Service Tax.

The Goods transport agency issuing consignment note should mention in addition to the requirements in the Service tax Rule 4A(1) that the agency has not claimed any CENVAT Credit on inputs and capital goods and the benefit of Not.12/2003.

Exemptions from Service Tax:

Total Exemption:	1) Transport of fruits, vegetables, eggs or milk by road 2) Gross Amount charged on individual consignments transported in a goods carriage does not exceed Rs. 750/- Gross Amount charged on ALL consignments transported in a goods carriage does not exceed Rs. 1500/- The intention is to discourage splitting of consignment to avoid Service Tax.
Partial Exemption:	Service tax will be payable by the Consignee/ Consignor only on the 25% of the gross amount charged by the Goods Transport Agency. This effective rate will be 3.09%. (ST+EC+SHE)

Frequently asked questions:

1. Is Small Service provider exemption available to Consignor/Consignee who is a service receiver? Service Receiver is made liable to pay Service tax as per Section 68(2) read with Rule 2(1) of the Service tax Rules. But exemption to Service Receiver is given vide notification. Thus the exemption is not applicable to receiver of service of Goods Transport Agency.

2. Can Consignor/ Consignee take the Credit of Service Tax paid by GTA?

Circular 97/6/2007-ST, dated August 23, 2007 issued to clarify certain procedural issues in Service Tax. It is clarified that as per Rule 3 of CENVAT Rules, 2004, CENVAT Credit of service tax leviable and paid on any 'input services' can be taken. Thus the rule does not distinguish as to who (i.e, GTA, the consignor or the consignee himself) has paid the aforesaid tax. The only condition is that the consignee must be a manufacturer of exiscable goods or a provider of a taxable service and the service must be in the nature of 'input service' for such activity.

3. Can Service Receiver avail CENVAT credit of Service Tax paid by him?

The Service Receiver can avail CENVAT credit of Service tax paid on the basis of the Service Tax challan used for payment of Service Tax. There were doubts expressed whether outward freight from the place of removal is available for availing CENVAT credit of Service tax paid by Service receiver. This is because the list included in the definition of input service is an inclusive definition, but the last clause in the list is "outward freight upto the place of removal", However in the case of **Gujarat Ambuja Cement Ltd CCE (2007) 8 STT 122 (CESTAT)** it is made clear that outward freight is not input service and held that service tax paid on the cost of transportation from the factory/ depot to the buyers' premises, would not be available as credit.

However, a contrary decision is given in the case of **THE INDIA CEMENTS LIMITED v.CCE, Tirupathi dated August 13 2007** where the Tribunal has disagreed with the decision rendered in **Gujarat Ambuja Cement Ltd CCE (2007) 8 STT 122 (CESTAT)**. In this case the Tribunal has held that the Service tax paid on the Goods transport services availed by the manufacturer from the factory upto the destination of the buyer is definetly included as Input service.

The matter is referred to a Larger Bench.

Further in Circular 97/6/2007-ST, dated August 23,2007, it has been clarified what is place of removal for the purpose of the inclusion of "outward transportation upto the place of removal" in the definition of Input Service. As per the circular in situations where manufacturer/ consignor may claim that the sale has taken place at the destination point because in terms of the sale contract / agreement

- (i) the ownership of goods and the property in the goods remained with the seller of the goods till the delivery of the goods in acceptable condition to the purchaser at his door step;

- (ii) the seller bore the risk of loss of or damage to the goods during transit to the destination; and
(iii) the freight charges were an integral part of the price of goods.

In such cases, the credit of the service tax paid on the transportation up to such place of sale would be admissible if it can be established that sale and transfer of property in goods occurred at the said place.

Thus at present there is lots of confusion and a final decision in this area at the earliest will be a boon to payer of Service tax on Goods Transport by road.

CORPORATE VALUE ADDITION - THE HIDDEN TREASURE

-Komal, Tanuja, Priya, Vinay J, Chetan

Mittal Steel Corp sets out for shopping. It zeroes-in on a target company. The target company has barely been in existence for four years with a bad profit record & locational advantage being the attraction for the proposed take-over deal. What price will the predator be willing to pay for acquisition of such a business? Definitely a nominal one. On the other hand, let's suppose the target company has been in existence for over fifteen years now with an impressive profit record. In addition it has a healthy dividend payout history & has won accolades for customer satisfaction. Now, what price will the predator be willing to pay to acquire the business? Definitely a substantial one. Why this discrimination? & on a closer analysis we would find that the price offered often surpasses the net asset value of the target. The additional consideration is often on account of the standing of the target in the market & also by the reason of its extra profit earning capacity compared to other businesses in the same industry. The whole thing cracks down to one point i.e., there is an existence of a special element in the latter target as compared to former target. This special element is "Goodwill" as per an accountant's dictionary.



Be it a simple admission of a partner to the profits of a firm, or be it a high-funda corporate merger or an acquisition deal, payment for goodwill becomes inevitable. A series of questions crop up in this regard. How can value be attached to goodwill? Or how can it be quantified? What are the criterions which determine its valuation?

What is Goodwill?

Goodwill is an accounting term used to reflect the portion of the market value of a business entity not directly attributable to its assets and liabilities; it normally arises only in case of an acquisition. It reflects the ability of the entity to make a higher profit than would be derived from selling tangible assets. Goodwill is also known as an intangible asset.

Now let's have a look on various methods of goodwill valuation followed by explanation of various terms used in goodwill valuation.

Valuation methods: There are basically four methods of goodwill valuation.

1) Capitalization Method: This method consists of the following steps:

- ◆ Determine Actual Capital Employed (ACE):
- ◆ Determine Normal Rate of Return (NRR)
- ◆ Determine Future Maintainable Profit (FMP)
- ◆ Determine Normal Capital Employed (NCE)
- ◆ Determine Goodwill

Example I: The Balance Sheet of Mr. Bachhan discloses the following position on 31.12.2006

Balance Sheet

<u>Liabilities</u>	<u>Rs.</u>	<u>Assets</u>	<u>Rs.</u>
Share Capital	5,00,000	Land & Buildings	3,00,000
General Reserve	2,00,000	Plant & Machinery	4,00,000
Profit & Loss A/c	50,000	Stock	2,00,000
Trade Debtors	4,50,000	Debtors	2,00,000
Creditors		Cash & Bank	1,00,000
	<u>12,00,000</u>		<u>12,00,000</u>

Additional Information's

- ◆ Bachhan Limited was incorporated on 1st Jan 1995 and its first accounts were made upto 31st Dec 1995.
- ◆ It manufactures abrasive materials involving technical skill and it has engaged two foreign experts since 1995.
- ◆ No provision for taxation is required
- ◆ The Fixed Assets of the company is adequately depreciated
- ◆ The present market value of its Land & Buildings is Rs.5,00,000 and of Plant & Machinery Rs.6,00,000.
- ◆ The profit & losses of the company for the last 3 years after charging depreciation & tax have been as follows: 2001- Rs 1,01,000; 2002- Rs. 1,50,000; 2003- Rs. 1,69,000
- ◆ The sales of the company during last 3 years were Rs. 12,99,000; Rs.13,77,000; & Rs. 18,22,000.
- ◆ The investor wants 4% additional return on his investment to cover the risk attached. If bank rate is 6%, calculate normal expectation of the investor.

- ◆ The investor wants 4% additional return on his investment to cover the risk attached. If bank rate is 6%, calculate normal expectation of the investor.

Calculate the value of Goodwill of Bachhan Ltd. under Capitalisation Method.

Solution:

Step 1: Determination of Actual Capital Employed:

Goodwill

Capital employed represents the fair value of the net assets used in the business for earning the profits. Following points also should be kept in mind while calculating capital employed.

- ◆ Non trading asset & fictitious asset should be ignored while calculating capital employed (E.g.: Non trade investments)
- ◆ Fixed asset, stocks, etc should be valued at current cost.
- ◆ Book value of goodwill, if any, to be ignored. Purchase goodwill, if any, is to be taken into account.
- ◆ Debentures & Loans are not part of capital employed when shareholder's fund approach is followed.

Actual capital employed is neither the opening capital employed nor the closing capital employed. It should be the average capital employed.

Average capital employed can be calculated in any of the following manner:

- ◆ $\text{Average Capital Employed} = \frac{(\text{Opening capital employed} + \text{Closing capital employed})}{2}$
- ◆ $\text{Average Capital Employed} = \text{Opening capital employed} + \frac{1}{2} \text{ of profit earned during the year.}$
- ◆ $\text{Average Capital Employed} = \text{Closing capital employed} - \frac{1}{2} \text{ of profit earned during the year.}$

With reference to the above given problem, Actual Capital Employed can be calculated as follows:

Statement of Actual Capital Employed:

Particulars	Rs
Land & Building	5,00,000
Plant & Machinery	6,00,000
Stock	2,00,000
Debtors	2,00,000
Cash & Bank	1,00,000
Less: Creditors	(4,50,000)
Actual Capital Employed	<u>11,50,000</u>

Step 2: Determination of Normal Rate of Return:

NRR represents the rate of return expected from industry comprising enterprises of similar size. It is the aggregate of **risk free return** and **risk premium**.

Risk Free Return is the rate of return from Risk Free Investment. For E.g.: Return on Government Securities. Risk Premium is the additional return a businessman expects due to the investment in a risky project as a compensation for the risk undertaken.

With reference to the above given problem, Normal Rate of Return can be calculated as follows:

Normal Rate of Return = Risk free rate + Risk premium = 6% + 4% = 10%

Step 3: Determination of Future Maintainable Profit:

Future Maintainable Profit (Earning After Tax) is calculated taking into account the past profits. It is calculated in the following manner:

Since past profits are used to make an estimation, it is necessary to make appropriate adjustments for better estimation. The adjustments are made with respect to the following:

- ◆ Elimination of any abnormal effect in the past profit
- ◆ Any income from non-trading assets
- ◆ If there is a change in the rate of tax, new tax rate should be applied in the past profits
- ◆ Effect of change in accounting policies should be neutralized.

Future Maintainable Profit is calculated:

- ◆ Taking the Simple Average of the adjusted Past Profits calculated under Step 1 when the adjusted past profits do not show any definite trend.
- ◆ Weighted Average of the adjusted Past Profits calculated under Step 1 when the adjusted Past Profits show definite trend.

With reference to the above given problem, Future Maintainable Profit can be calculated as follows:

Statement of Future maintainable Profit

Profits as a percentage of sales are as follows:

2001 – $1,01,000/12,99,000 \times 100 = 7.78\%$

2002 – $1,50,000/13,77,000 \times 100 = 10.89\%$

2003 – $1,69,000/18,22,000 \times 100 = 9.28\%$

Since profit as a percentage of sales does not reflect any definite trend, we can take simple average. So, the Future maintainable Profit is: $(1,01,000 + 1,50,000 + 1,69,000)/3 = \text{Rs.} \underline{1,40,000}$.

*Don't compare your self with anyone in this world. If you do so,
you are insulting yourself.*

- Alen Strike (4)

Step 5: Determination of Goodwill: Goodwill under Capitalisation method is calculated as follows:

Goodwill = Normal Capital Employed – Actual Capital Employed.

With reference to the above given problem,

Goodwill = Rs.14, 00,000 – Rs.11, 50,000 =

Rs. 2,50,000

2) Super Profit Method: This method consists of the following steps:

- ◆ Determine Actual Capital Employed (ACE)
- ◆ Determine Normal Rate of Return (NRR)
- ◆ Determine Normal Profit (NP)
- ◆ Determine Future Maintainable Profit (FMP)
- ◆ Determine Super Profit (SP)
- ◆ Determine Goodwill

Example II: Consider example I & calculate the value of Goodwill of Bachhan Ltd. on the basis of 5 years of purchase under Super Profit Method:

Solution:

Step 1: Determination of Actual Capital Employed:

Actual Capital Employed = Rs. 11,50,000 (As calculated above)

Step 2: Determination of Normal Rate of Return:

Normal Rate of Return = 10% (As calculated above)

Step 3: Determination of Normal Profit: Normal Profit is calculated as follows:

Normal Profit = Actual Capital Employed * Normal Rate of Return

With reference to the above given problem, Normal Profit = Rs.11,50,000*10% = Rs. 1,15,000.

Step 4: Determination of Future Maintainable Profit:

Future Maintainable Profit = Rs. 1,40,000 (As calculated above)

Step 5: Determination of Super Profit: Super Profit is calculated as follows:

Super Profit = Future Maintainable Profit – Normal Profit

With reference to the above given problem, Super Profit = Rs 1,40,000- Rs 1,15,000= Rs 25,000.

Step 6: Determination of Goodwill: Goodwill under Super Profit method is calculated as follows:

Goodwill = Super Profit * Number of years of purchase

With reference to the above given problem,

Goodwill = Rs.25, 000* 5 = **Rs.1,25,000**

3) Annuity Method: Annuity method is same as super profit method. The only difference is super

profit method does not take into account time value of money. Under annuity method present value of future profit is taken into account.

Goodwill = Super profit* Discounting rate @ 15% for 5 years

Example III: Consider example II & calculate the value of Goodwill of Bachhan Ltd. on the basis of 2 years of purchase under Annuity Method. Discounting rate being 15%.

Solution:

With reference to the above given problem,

Goodwill = Rs. 25,000*3.352 = **Rs. 83,800.**

Note: Discounting rate @ 15% for 5 years = 3.352

4) Sliding scale valuation method: Simple number of years purchase method is based on the implicit assumption that the amount of super profit per annum remains same for a fixed number of years and after that the super profit would disappear. As against this, sliding scale method is based on more realistic assumption that the amount of super profit per annum would decrease every year and after a fixed period of time super profit would disappear.

Example IV: The amount of super profit were estimated at Rs.25,000 and it also estimated that the first Rs.12,000 profit would be purchased for 3 years, next Rs.8000 profit would be purchased for 2 years and balance Rs.5000 profit would be purchased for 1 year.

Solution: **Goodwill** under sliding scale valuation method = [(Rs.12000*3) + (Rs.8000*2) + (Rs.5000*1)] = **Rs.57, 000**

Goodwill valuation with reference to AS-11:

Certain items appearing in the balance sheet, which form a part of computation of capital employed, attract applicability of AS-11 dealing with accounting for fluctuation in foreign exchange rates.

Transactions involving foreign currencies should be recorded by applying the exchange rate between the reporting currency & the foreign currency at the date of the transaction.

For reporting at the end of each accounting period, items in the balance sheet are required to be classified into monetary and non-monetary items. For translation of balance sheet items that are denominated in foreign currency, the following principles apply:

- ◆ Apply closing rate for monetary items like cash balances, account receivables & payables.
- ◆ Apply transaction-date rate or the rate that existed on fair-value estimation date for non-monetary items.

Example V: From the following, show adjustment in profits due to change in accounting policy with respect to gain/loss for foreign exchange rate fluctuations:

<u>Year</u>	<u>PAT</u>	<u>Tax Rate</u>
1999	1728	46%
2000	1456	48%
2001	864	52%

Additional information:

The company has export sales. Sundry debtors at different balance sheet date in dollar terms and in rupee terms are given below along with their collection amount:

<u>Year End</u>	<u>Sundry debtors (\$)</u>	<u>Sundry debtors (Rs)</u>	<u>Year end exchange rate</u>	<u>Collection time exchange rate</u>
31.12.1999	80,000	880,000	11.20	-----
31.12.2000	90,000	10,80,000	12.10	12.20
31.12.2001	60,000	780,000	13.25	13.50

Sundry debtors outstanding at the end of a year are collected in the next year. The company charges profit/loss arising out of exchange rate fluctuations in the year of collections.

Solution: Statement of adjustment in profits due to change in accounting policy with respect to gain/loss for foreign exchange rate fluctuation:

<u>Year</u>	<u>Effect already considered</u>	<u>Effect to be considered</u>
1999	Nil	$(11.20-11)*80,000 = 16,000$
2000	$(12.20-11)*80,000 = 96,000$	$[(12.20-11.20)*80,000] + [(12.20-12)*90,000] = 89,000$
2001	$(13.50-12)*90,000 = 135,000$	$[(13.50-12.10)*90,000] + [(13.25-13)*60,000] = 141,000$

Note:

To determine effect already considered for a particular year we have to consider the following:

- ◆ Last year's sale date exchange rate 'and'
- ◆ Current year's collection time exchange rate.

To determine effect to be considered for a particular year we have to consider the following:

- ◆ Opening balance sheet date rate & collection time rate for the year.
- ◆ Current year sale date rate & closing balance sheet date rate.

The very fact that goodwill is an intangible asset makes its valuation a challenging task. Unlike other tangible assets like building or machinery whose fair market values are readily

available for valuation purposes, the same is not the case with goodwill. Hence it becomes inevitable for business houses to take the aid of any one of the above-discussed methods of valuation in order to quantify this intangible. The factors determining goodwill differ from case to case & depending on the situation, the nature of business, information at hand & future estimates an appropriate valuation method can be adopted to come up with a fair value for this component. On a conclusive note, since the valuation process is not governed by any statute or an accounting standard, one can always explore a possibility of coming up with a better valuation method which attaches a near perfect value to this Hidden Treasure!!

LAW DICTIONARY

Law is a code that regulates the behavior of members of a society. It affects almost everything we do - buying a house, getting a job, and making a will or getting divorced, for example.

Even something as simple as buying a bar of chocolate is covered by numerous laws:

- ? The law of contract;
- ? Company law;

- ? Sale of goods, food and drugs legislation;
- ? Occupiers' liability;
- ? Trade's descriptions law!

So we can imagine how important it is for a common man to know the meaning of Law and its implications in one's life.

A Law Dictionary is a dictionary that is designed and compiled to give information about terms used in the field of law.

Follow this column for a complete update on the terminologies used in the field of law.

- Tanuja K 

Inter corporate Loans & Investments-Auditor's Desk

-Mithila, Deepti, Bherulal, Mikita, Deepak, Sneha

Economic developments in India in 1998-99 had slowed down. The corporate sector was passing through difficult times and the capital market was at low ebb requiring immediate morale boosting to promote investor's confidence.

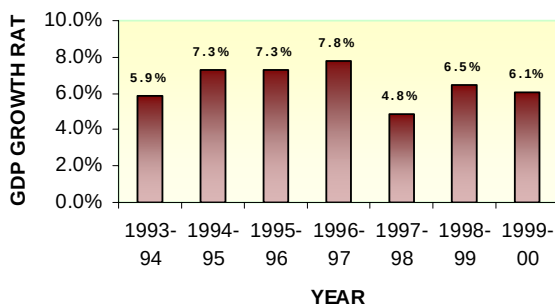
The Government considering the fact that the economy needed an impetus for promoting inter-corporate investments in the backdrop of slow down in investments in new companies, inserted section 372A by the Companies (Amendment) Act, 1999 [w.e.f. 31st October 1998]



Inter-corporate loans and inter-corporate investments were regulated by section 370 and 372 respectively. Section 370 and 372 required the prior approval of the Central Government for providing loans or making investments exceeding the ceiling limit. Under the newly inserted section 372A the approval of the Central Government has been dispensed with altogether.

In case of default in complying with the provisions of this section [other than maintenance of registers], the company and every officer of the company who is in default shall be punishable with imprisonment which may extend to 2 years or with fine which may extend to Rs. 50,000/-.

INDIA - GDP GROWTH (%)



Before amendment

Sec. 370 : Inter-corporate loans

30% of the aggregate of subscribed capital and free reserves of the lending company.

Sec. 372 : Inter-corporate investments

30% of the aggregate of subscribed capital and free reserves of the investing company;

and / or

30% of the subscribed equity share capital or the aggregate of the paid up equity and preference share capital of the investee company.

After amendment

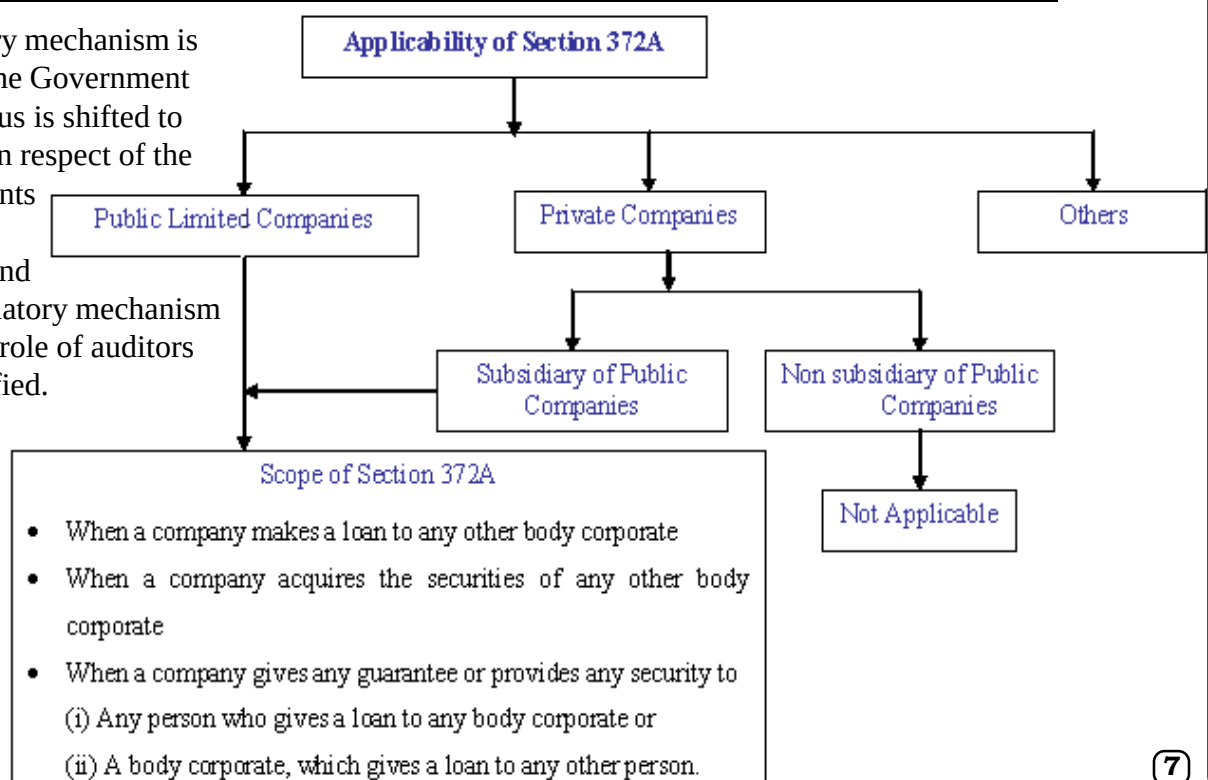
Sec. 372A : Inter-corporate loans and investments

60% of the paid-up share capital and free reserves or 100% of its free reserves, whichever is more, **with the approval of the board.**

In excess of 60% of the paid-up share capital and free reserves or 100% of its free reserves, whichever is more, **with the approval of the company in general meeting by a special resolution.**

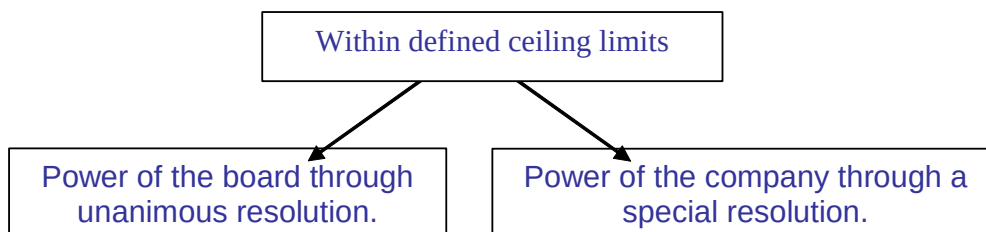
A self-regulatory mechanism is introduced by the Government wherein the onus is shifted to the corporates in respect of the loans, investments and guarantees.

In the background of the self-regulatory mechanism introduced, the role of auditors has been amplified.



I. CARO requires reporting by the auditor -

- + for the grant or for obtaining loans, secured or unsecured to / from corporates;
- + whether such loans have been made at such terms and conditions that are prima facie prejudicial to the interest of the company;
- + for giving guarantees for loans taken by others from banks or financial institutions and whether such terms are prejudicial to the interest of the company.

II. Verification of adherence to the provisions of Section 372A by auditor**a. Power of the board**

- + The approval of the board is required in all cases either for making a loan or an investment or giving a guarantee.
- + The approval of all the directors present at the meeting must be obtained by passing a resolution.
- + The company is not required to give a specific notice.

b. Power of the company

- + The special resolution shall be passed by way of postal ballot if the company is a listed company.
- + The special resolution shall be passed in the general meeting if the company is not a listed company.

III. Legal compliances

- + Prior approval of the public financial institution is required if there is a default in the repayment of principal or interest on term loan taken from it in case of any subsisting term loan, only if the ceiling limit is exceeded.
- + The company has complied with the provisions of Section 58A.
- + Filing of Form 23 with the respective ROC.

Inter-corporate loans shall not be made at a rate of interest lower than the bank rate, being the standard rate made public under section 49 of the RBI Act, 1934. Raising of loans through inter-corporate loans is a popular method since short term funds can be raised without much formalities and at a reasonable rate of interest. For companies, which are lending, it gives them a good return on surplus funds not required immediately. Similarly, companies may provide security or guarantee in connection with a loan.

Meanings:

Loans: It includes debentures or any deposit of money made by one company with another company, not being a banking company

Free Reserves: means those reserves which, as per the latest audited balance sheet of the company, are free for distribution as dividend and shall include balance to the credit of the securities premium account but shall not include share application money.

Paid Up Capital: Paid-up capital is essentially the portion of authorized share capital that the company has issued and received payment for.

Winning doesnot always mean being first, winning means you're doing better than you've done before

- Bonnie Blair 8

Deeming Dividend- A Twist in the Tale?

-Soumitra, Udaya, Harish, Puneeth, Mitesh, Pavitra



"A Cauliflower inspite of being a flower, is a vegetable", "Kamal Hassan was a woman in the movie chachi 420 & so was Robin Williams in Mrs Doubtfire". One thing which stands out in the above mentioned lines is, things can take a form of something which they are not!! An immediate question would be, What is it got to do with this article? Interestingly the Income Tax Act contains similar situations in the form of "Deeming Provisions"

The Income Tax Act contains a wide array of deeming provisions like Deemed Income, Deemed Profits, Deemed to Accrue or Arise in India, so on & so forth. The word 'Deemed' in common parlance means 'to regard as' or 'to consider as' or to be more clear it is used to call or consider a thing, something which it is not. However attention is drawn to the fact that the word Deemed is used in different senses by the Act. The intention of using this word can take any of the following forms:-

- ✚ It can be used to give a comprehensive description that includes what is obvious. Eg: making a statement that the Word Fruit includes an apple which is quite obvious!
- ✚ It can be used to put beyond doubt a particular construction that might be otherwise uncertain. Eg: removal of uncertainty relating to classification of income as capital gains or other income under clauses (c) & (d) of Section 2 (22)
- ✚ Lastly it may be used to create a 'Legal Fiction' by giving an artificial or extended meaning to a word.

Here the Act gives a word or a transaction a status of what it otherwise would not have been.

Eg: Treating Tusshar Kapoor as Shahrukh Khan & casting him in a movie.

The Act may frame a deeming provision explicitly by using the word Deemed in the heading of a Section like in the case of Deemed Profits, or may frame it implicitly in the form of an inclusive definition, like the definition of Dividend U/s 2 (22) which is the point of discussion of this article.

Section 2 (22) defines the term Dividend for the purposes of income tax & contains five clauses starting with clause (a) & terminating with (e) with each covering five different cases.

As dividend requires the existence of profits, dividend under this section also requires such

existence & the term Accumulated Profits comes into picture. Dividend under this section is **restricted to the amount of accumulated profits** of the company & hence it becomes imperative to analyze the constituents of this word.

Accumulated Profits for the purpose of Section 2(22):

- ✚ In case of a company (which is not in liquidation), it includes all profits of a company up to the date of distribution or payment.
- ✚ However, in the case of a company in liquidation it includes all profits of the company up to the date of liquidation.



- ✚ Where, the liquidation is consequent on the compulsory acquisition of a company's undertaking by the Government Company, accumulated profits do not

include any profits of the company prior to the three successive years immediately preceding the previous year in which such acquisition took place.

- ✚ This term includes a surprise packet in the form of 'Capitalized profits' (Bonus Shares) covering sub-clauses (a) to (d).

Now, once the stage is set, the curtain can be raised & the clauses relating to Dividend can be unleashed.

Distribution Entailing Release of Assets Section 2(22) (a)

The deeming provision kicks off by bringing into the ambit of dividend any distribution by the company involving release of assets to the extent of accumulated profits whether capitalized or not. The following two conditions have to be fulfilled for dividend to arise under this section:

- ✚ Distribution has to be from the accumulated profits only and not from capital.
- ✚ Such distribution must necessarily result in the release of the company's assets.

The assets distributed maybe fixed assets or current assets or even investments! Where a company distributes amongst its shareholders the shares held by it in another company, the same amounts to dividend. The quantum of dividend will be the market value of assets on the date on which the shareholders are entitled to receive dividend [CIT v. Central India Industries Ltd (SC)].

Distribution of Debentures or Bonus Shares in Certain Cases Section 2(22) (b)

Under this clause the following two distributions by the company to the extent of accumulated profits whether capitalized or not are treated as dividend:

- + Distribution by a company to its shareholders (whether equity or preference) of debentures, debenture-stock or deposit certificates given by the company for non-issuance of dividend in any form, whether with or without interest; and
- + Distribution as bonus shares to its 'preference shareholders'.

It's worthwhile to note that under this clause distribution amounts to dividend even if there is no release of assets at the time of distributions.

Distribution by a Company in Liquidation Section 2(22) (c)

ABC Ltd goes into liquidation and its liquidator distributes the surplus to all shareholders. If you being a shareholder of the Company think that the amount received on liquidation would merely constitute capital gains, then you are in the wrong notion.

Under this clause, any distribution made to the shareholders on liquidation of the Company is considered as 'Dividend' to the extent of the company's accumulated profit whether capitalized or not and consequently taxable as income in the hands of shareholders. However any distribution out of the profits earned after liquidation is not covered under this clause..

Quantum of distribution to be treated as Deemed Dividend

Each distribution made by the liquidator is treated as dividend to the extent it is attributable to accumulated profits. Therefore, the distribution would be split in the ratio of the company's share capital & accumulated profits. The portion attributable to the share capital would constitute capital repayment & that attributable to the accumulated profits would be assessable as dividend. [CIT v. Girdhardas & Co (SC)].

For instance: If the share capital & general reserve of a liquidating company is Rs.5,00,000 and Rs.7,00,000 and the company distributes Rs.60,000 to a particular shareholder, then **Rs.35,000 is treated as dividend & the balance Rs.25,000 is attributable towards share capital.**

Amount Distributed by a Company on Account of Capital Reduction Section 2(22) (d)

This clause covers the situation of capital reduction. Under section 2(22)(d) any distribution to the shareholders on account of reduction of capital is treated as 'Dividend' to the extent the Company possesses accumulated profits whether capitalized or not. The wording 'to the extent of accumulated profit' indicates that the distribution received will be first treated as dividend & then will be classified as capital repayment. In this regard a reference can be drawn to the case of Colgate-Palmolive India Ltd. On May 9th of this year the company announced reduction of its capital by reducing the face value of its shares from Rs.10 to Re.1 thereby announcing a 'Deemed Dividend' of Rs. 9 to its shareholders

However, the following are not treated as dividend:

- + Any distribution in respect of preference shares issued for full cash consideration.
- + A case where there is a re-organization or splitting up of the capital of the Company .

Loan or advance given by a Closely Held Company in certain situations Section 2(22) (e)

This is the clause which has the real effect of creating a 'Deeming Fiction'. This clause takes the shareholder for a roller-coaster ride by bringing into the tax net certain payments which, by any stretch of imagination cant be termed as income in the first place. here the Act expands the scope of the term Dividend altogether The following two payments by closely held companies are deemed to be dividends, to the extent of accumulated profits:

- + Any loan or advance given to a shareholder having 'Beneficial interest'.
- + Any loan or advance given to a 'Concern' in which the above mentioned shareholder has 'Substantial interest'.

It is very important to understand the meaning of the terms used in the provision in order to have a clear picture of it.

- Closely held company: is the one which does not have any public interest, Private Companies in general.
- Beneficial Interest: Minimum of 10% of the shareholding of the company
- Concern: Can be in the form of a HUF, AOP/BOI, Partnership Firm or a Company.
- Substantial Interest: In case of a company means at-least 20% of the shareholding & for any other concern relates to entitlement of at-least 20% of the share in profits.

Chuckles:

Who's an auditor?

Someone who arrives after the battle and bayonets all the wounded.

Quantum of Dividend

An important issue under this clause is the quantum of the dividend amount:- it must be noted that the amount that is deemed to be dividend does not have any relevance to the percentage of shares held by the holder as in other clauses, E.g. If a person holds 15% of shares in a company & the whole amount of accumulated profit is given to him as loan; then the whole amount that is given to him will be considered as deemed dividend. This clause was enacted to curb the malpractices by certain shareholders amounting to misutilization of company's funds.

Who Carries the Burden of Tax?

The discussion now leaves us with the question of onus of tax. Is it the company? Or the shareholder? who is made to bite the dust??. The following table throws light on the question.

Incidence of tax on deemed dividend:

<u>U/s 2 (22)</u>	<u>Domestic Companies</u>	<u>Foreign Companies</u>
(a)	Company	Share Holder
(b)	Company	Share Holder
(c)	Company	Share Holder
(d)	Company	Share Holder
(e)	Share Holder	Share Holder

Note: The Domestic Companies { clauses (a) to (d)} are liable for tax on distribution of dividends as

envisaged in Section 115-0 at 12.5%+surcharge+education cess bringing the total tally to 14.025% & hence it becomes tax-free in the hands of the shareholders by virtue of Section 10 (34). In case of dividend under sub clause (e), the shareholder has to offer the same to tax as Income from other sources.

As mentioned in the outset, the word deemed can be used by the Act for more than one purpose. In this backdrop we can seek to analyze the five clauses of Section 2 (22).

- ✚ The clauses (a) & (b) seem to be providing a description of what is obvious, as the distributions contained there-in are dividends in normal sense.
- ✚ The next two clauses i.e, (c) & (d) remove the uncertainty as to whether the income should be treated as capital gains totally or some portion constitutes dividend
- ✚ The last clause (e) clearly enlarges the meaning of the term dividend by bringing into its ambit certain matters which otherwise may not fall within the provision.

Amongst the various clauses of Section 2 (22), clause (e) is a hard hitting one since the shareholder suffers a 'Double-Whammy'. He is cast with the burden of paying tax on the amount availed by him though he may repay the amount in future. This clause is indeed harsh in nature but, it demonstrates the power of the weapon available with the revenue in the form of 'Deeming Provisions'.

Enhancing Wealth Creation..... Corporate Governance

-Saurabh, Shilpa, Bharath, Amar, Nikhil

Introduction

"There are those who will tell you that business and ethics cannot stand together. In the short run it might appear that companies pay a price for adhering to values while their competitors get ahead in a shorter time frame, but in the long run people would learn to distinguish, stakeholders learn to ask the right questions, and distinguish between the grain and chaff. Those that don't subscribe to values will fall by the way side; those that subscribe to values will last the course and will set benchmarks."



Remarks at a seminar on 'business ethics' organized by the Loyola Institute of Business Administration (LIBA) on March 15, 2007.

Need for the Corporate governance.....?

Knowledge has surpassed machines and the stored value of money itself, as the driving force behind the world economy. In the recent past, companies learned they could create better products more efficiently with the full mental participation of their employees. Today, investors are learning that participation by shareowners also adds value. Venture capitalists that are willing to invest ideas, as well as money, are outperforming the market. The advantage of the wealth maximization takes over the disadvantage of the profit maximization.

**M. Damodaran Chairman,
Securities and Exchange Board of India**

What does corporate governance mean?

Corporate governance is the set of processes, customs, policies, laws and institutions affecting the way in which a corporation is directed, administered or controlled. Corporate governance also includes the relationships among the many players involved (the stakeholders) and the goals for which the corporation is governed. The principal players are the shareholders, management and the board of directors. Other stakeholders include employees, suppliers, customers, banks and other lenders, regulators, the environment and the community at large.

Parties to corporate governance:-

Parties involved in corporate governance include the regulatory body (e.g. the Chief Executive Officer, the board of directors, management and shareholders). Other stakeholders who take part include suppliers, employees, creditors, customers and the community at large.

In corporations, the shareholder delegates decision rights to the manager to act in the principal's best interests. This separation of ownership from control implies a loss of effective control by shareholders over managerial decisions. Partly as a result of this separation between the two parties, a system of corporate governance controls is implemented to assist in aligning the incentives of managers with those of shareholders. With the significant increase in equity holdings of investors, there has been an opportunity for a reversal of the separation of ownership and control problems because ownership is not so diffuse.

A board of directors often plays a key role in corporate governance. It is their responsibility to endorse the organisation's strategy, develop directional policy, appoint, supervise and remunerate senior executives and to ensure accountability of the organisation to its owners and authorities.

The Company Secretary, known as a Corporate Secretary in the US and often referred to as a Chartered Secretary if qualified by the Institute of Chartered Secretaries and Administrators (ICSA), is a high ranking professional who is trained to uphold the highest standards of corporate governance, effective operations, compliance and administration.

All parties to corporate governance have an interest, whether direct or indirect, in the effective performance of the organisation. Directors, workers and management receive salaries, benefits and reputation, while shareholders receive capital return. Customers receive goods and services; suppliers receive compensation for their goods or services. In return these individuals provide value in the form of natural, human, social and other forms of capital.

Revised Clause 49 of the listing agreement

SEBI, with a view to improve corporate governance standards in India, constituted the Committee on Corporate Governance under the chairmanship of Mr. N.



R. Narayana Murthy. This move of SEBI signifies the regulator's anxiety to ensure that the governance practices are corrected and improved upon expeditiously. The terms of reference to the committee were to review the performance of corporate governance and to determine the role of companies in responding to rumors and other price-sensitive information circulating in the market, in order to enhance the transparency and integrity of the market.

The committee came out with two sets of recommendations: the mandatory recommendations and the non-mandatory recommendations. The mandatory recommendations focus on strengthening the responsibilities of audit committees, improving the quality of financial disclosures, including those pertaining to related party transactions and proceeds from initial public offerings, requiring corporate executive boards to assess and disclose business risks in the annual reports of companies, calling upon the Board to adopt a formal code of conduct, the position of nominee directors and improved disclosures relating to compensation to non-executive directors and shareholders' approval of the same.

The non-mandatory recommendations pertain to moving to a regime providing for unqualified corporate financial statements, training of Board members and evaluation of non-executive directors' performance by a peer group comprising the entire Board of Directors, excluding the director being evaluated.

SEBI has incorporated the recommendations made by the Narayana Murthy Committee on Corporate Governance in Clause 49. Clause 49 as revised was made effective from January 1, 2006. We fully comply with the revised Clause 49 of the listing agreement.

Conclusion:

The keys to creating wealth and maintaining a free society lie primarily in the same direction. Both require that broad based systems of accountability be built into the governance structures of corporations themselves. Corporate governance has succeeded in attracting a good deal of public interest because of its apparent importance for the economic health of corporations and society in general. Infosys has been a pioneer in benchmarking its corporate governance practices with the best in the world.

The Information Hotpan

Has England lost its Identity?

The nation that identifies itself with invention of modern soccer, which plays at a stadium that styles itself as "the venue of legends," has failed to qualify for next year's European Championship.



Needing only a tie at home in its final qualifier, England allowed two quick goals in first half, leaving themselves with little hopes of come back against gritty Croatian defense.

The Croatians who had outthought outclassed and outfought their English counterparts in the first half were all set to bring in more agony and misery for the home fans in the second half.

England after a pep talk from their manager during the break came out with all guns blazing with Lampard converting the penalty and Peter Crouch bringing them back to level terms in the 65th minute thanks to a pin point cross by David Beckham in to the box.

With the equalizer it was almost certain of England qualifying for the Euro 2008 to be held in Austria-Switzerland. But the Croatians had something else in store for their opponents and in the 77th minute Mladen Petric got the goal that knocked out England from the Euro championship. And the country that identifies itself with inventor of modern football had certainly lost its identity.

-Harish, Komal, Soumitra & Puneeth

Interesting Facts Around Us...

1. The Great Wall Myth



It's a common mistake to say that 'The Great wall of China' is visible from outer space. It is too thin to be noticed from such a great distance. Only two man made structures visible from space are: The Pyramids of Giza and the Hoover Dam.

2. The Pyramids Were White



The stereotypical vision of the Egyptian Pyramids is large mountain like brown piles of stone uprooting from the desert having a rough contour. Though when first constructed around 2500 BC. The pyramids were paper white and as smooth as glass, topping the pyramid was a golden capstone that gleamed in the desert sun. It was an amazing spectacle. The pyramids somewhat stayed in this state until the Arab invasion of Egypt around AD 500. The Arab invaders stripped the pyramid of it's smooth limestone and built a huge section of Cairo.

3. Venus is the only planet that rotates clockwise.

4. A duck's quack doesn't echo and no one knows why.

5. Our eyes are always the same size from birth, but our nose and ears never stop growing.

TYPEWRITER is the longest word that can be made using the letters of only the top row of a standard keyboard.

Important Deadlines to be met!!

❖ Income Tax

December 15th: - Last date for payment of Advance tax. Non – corporates are expected to pay 60% of estimated tax & corporates 75% of estimated tax.

❖ Indirect Taxes

5th December * & - Last date for filing of monthly

5th January*

Service Tax & Excise Duty (excluding Individuals & Firms).

20th December &

20th January *

- Last date for filing of monthly returns for Professional Tax, Entry Tax & VAT

31st December

- Last date for Submission of KVAT Audit Report

*It is 6th December if the payment is made through internal banking.

Answers to Lateral Thinking - 6

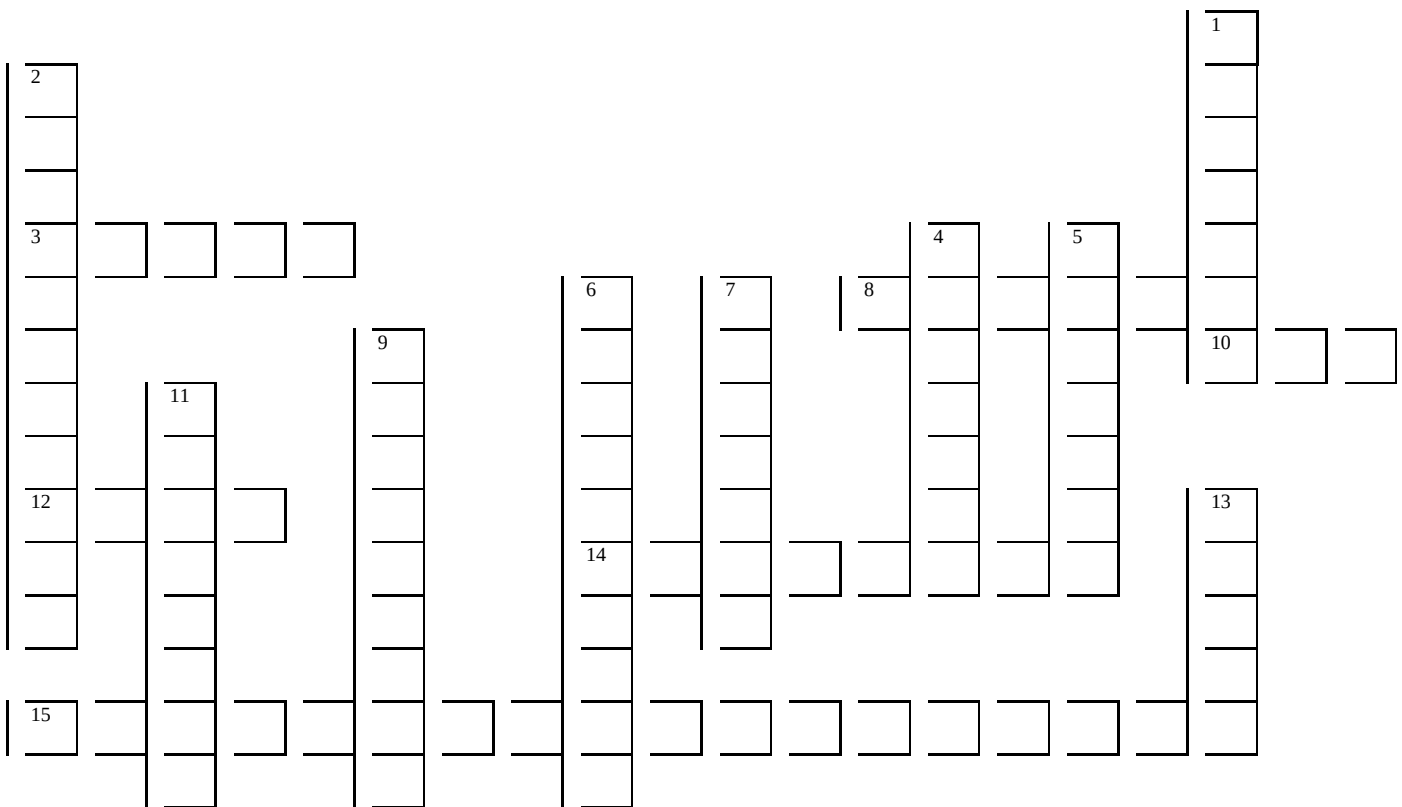
1. They are (respectively) the eyes, nose, and scarf of a snowman the boys had made. The snow has melted, leaving only these items in the middle of the field...
2. The stranger was their new born baby. The expectant couple were headed for the hospital. The child couldn't wait and the mother didn't survive the birth...
3. The hunter was near a snowy cliff. When he fired the gun, he "triggered" an avalanche.

4. The object she throws is a boomerang.

5. There are more of them...

6. Turn the first switch "On" and leave it "On". Turn the second switch "On", leave it for a few minutes before turning it "Off". Don't touch the third switch - leave it "Off". When you walk into the room, the light bulb for the first switch will be "On", the bulb for the second switch will be "Off" but still warm, and the bulb for the third will be "Off" and cold...

CROSSWORD - 7



ACROSS

- 3 Goods purchased by a business to resell to its customers.(5)
 8 The number of units of a product sold in a market over a period of time.(6)
 10 Measure of shareholder return.(1,1,1)
 12 Behavior rule which is a part of the ideology of the group.(4)
 14 Cost already incurred and cannot be recovered.(4,4)
 15 Relationship of fixed costs to total costs.(11,7)

DOWN

- 1 An application of information technology that identifies various aspects of product features, accuracy etc.(7)
 2 The concept of treating the transactions and valuation methods same way from year to year or period to period.(11)
 4 The ratio of share price divided by earnings per share.(1,1,5)
 5 Debt owed to a business not expected to be received.(3,4)
 6 Method of costing which identifies the individual costs of performing each job.(3,7)
 7 Right given by a company to an investor allowing him to subscribe for new shares at a future date at a fixed, pre determined price.(7)
 9 A technology that connects devices wirelessly, over a short range.(9)
 11 Alternative term for sales / revenue.(8)
 13 The length of time merchandise has been in stock.(5)

Shilpa & Pavithra

Answers: Crossword – 6

Across: 1-Debt Service, 4-Kathmandu, 5-Fiscal, 8-Statute, 12-Capital Structure, 15-Negative, 16- Write up, 18-Warranty, 19-Deficit, 20-Inquiry

Down: 2-Stagflation, 3-White collar worker, 6-SQL, 7-Assignee, 9-Operating, 10-File Volatility, 11-Hurdle Rate , 13-Line of credit, 14-T Account, 17-FAS

We make a living by what we get, we make a life by what we give.

- Winston Churchill ¹⁴

Reverse Mortgage Loan

-By Mrs. D Sailaja BSc(Agri),CAIIB & CA Rajani Shinde

"A BOON AND A RAY OF HOPE TO THE SENIOR CITIZENS"

Reverse mortgage is a very popular product in many countries. As a part of measures undertaken for financial and social security to Senior citizens, Finance Minister in his union budget speech 2007-08, introduced the concept of reverse mortgage for the senior citizens.

The scheme has a Special significance for -- senior citizens..

- For whom dependency in old age is increasing, resulting in financial insecurity.
- Looking for additional money, to support their needs at old age
- With less income, to offer their house as mortgage security.
- For whom, the house is their large component of wealth /investment ;
- Because of sentiments, selling their homes and moving elsewhere, are generally not very appealing to most older people;

❖ What is a Reverse Mortgage ?

"A Reverse Mortgage is a form of mortgage in which lender makes the payment to the owner of a house against the security of the house."

It is a loan against your home that one need not have to pay back for as long as he lives. With a reverse mortgage, one can turn the value of his home into cash without having to move or to repay the loan each month. The cash one gets from a reverse mortgage can be paid in several ways:

- a) all at once, in a single lump of cash;
- b) as a regular monthly cash advance;
- c) as a "creditline" account that lets you decide when and how much of your available cash is paid to you; or
- d) as a combination of these payment methods.

No matter how this loan is paid out to borrower, the loan is not required to be paid back as long as the house owner or his/her spouse occupies his/her property. Borrower need not sell his home, or permanently move out of his home.

How the Reverse mortgage differ from Forward Mortgage ?

The purpose of a reverse mortgage is different from that of a traditional "forward" mortgage. The

purpose of a forward mortgage is to purchase a home; the purpose of a reverse mortgage is to get cash from your home.

Forward Mortgage: When you purchased your home, you probably made a small down payment and borrowed the rest of the money you needed to buy it. Then you paid back your traditional "forward" mortgage loan every month over many years. During that time:

- ✚ your debt decreased; and
- ✚ your home equity increased

Reverse Mortgage : A "Rising Debt" Loan

- ✚ Your debt increased; and
- ✚ Your home equity decreased.

It differs from other home loans in the following important ways:

- ✚ you don't need an income to qualify for a reverse mortgage; and
- ✚ you don't have to make monthly repayments on a reverse mortgage.

Comparing "Forward" & Reverse Mortgages		
	Forward Mortgage	Reverse Mortgage
Purpose of loan	to purchase a home	to get cash from your home
Before closing, borrower has...	no equity in the home	a lot of equity in the home
At closing, borrower...	owes a lot, and has little equity	owes very little, and has a lot of equity
During the existence of loan, borrower...	makes monthly payments to the lender ; loan balance goes down; equity grows	receives payments from the lender; loan balance rises ; equity declines
At end of loan, borrower...	owes nothing; has substantial equity	owes substantial amount; has much less, little or no equity
Type of Loan	Falling Debt, Rising Equity	Rising Debt, Falling Equity

Salient features of the Reverse Mortgage :❖ **Eligibility :**

- Any senior citizen above 60 years, who is a owner of the house in his /her name can avail the loan. Restricted to self-acquired and self-occupied residential properties, with absolute, clear title /conveyance, free from encumbrance and saleable. It should be a principal residential house/flat, located in India. The property should have a residual life of at least 20 years.
- In the case of joint owners of the house, in the event of the death of the husband/wife , the spouse will be entitled to continue to live in the house and may get monthly payment (if so opted) till he/she continue to survive. The loans become due and payable only when the last surviving owner dies.

❖ **Eligible loan amount:**

- Normally, Lenders do not check the income and credit history of the borrower to grant the loan.
- Loan amount depends upon the age of the borrower, as well of the value of the property, interest rate and closing cost of the home loan in the neighborhood of the borrower.
- Before availing the mortgage, the borrower has to first pay off his previous debts or he may also repay them from the cash obtained from the reverse mortgage.
- The upper limit of loan, differs from bank to bank. Indian bank is offering maximum loan amount of Rs. 40 lakhs and the maximum loan amount along with interest is restricted to Rs. 100 lakhs.

❖ **Valuation of property:**

- Bank will determine the Market value of the residential property through their approved valuer(s) and loan is based on realizable value which is 10% less than the Market value.
- Valuation is required to be done at least once in three years. The methodology of revaluation process and the frequency /schedule of revaluations will be clearly specified to the borrowers upfront.
- The Value of the property is assessed by Independent valuation.
- The property should have a residual life of at least 20 years.
- Residential property should comply with the local residential land-use and building bye laws stipulated by Local Authorities, with duly approved lay-out and building plans.

❖ **Margin :**

- Margin insisted for the scheme, differs from bank to bank.
- Presently, Indian bank is insisting a margin of 61% of Realizable value of property and 39 % is considered as value of loan amount.

❖ **Purpose of loan:**

- Medical, Emergency expenditure, supplementing pension/other income, meeting any other genuine need. (Speculative and trading purposes will not be permitted).

❖ **Payment terms by Bank:**

- Borrowers can avail payment against the security of their houses on monthly or quarterly installments or either he/she can go for as a lump sum payment at the beginning. Or as a combination of these payment methods, are also offered by some banks. Presently, Indian bank is considering a lumpsum payable upto 20 % of eligible loan amount for all purposes and it is on a selective basis, as a special case.
- The policy with regard to payment terms differs from bank to bank.

❖ **MONTHLY ANNUITY AMOUNT PAYABLE – Linked to property value**

*PERIOD 180 MONTHS

* RATE OF INTEREST 10 % pa

AMOUNT in Rs.

S.No	Realisable value of the property	Loan amount	Annuity Amount payable every month
1.	1,00,000	39,000	216
2.	5,00,000	1,95,000	1080
3	10,00,000	3,90,000	2160
4.	20,00,000	7,80,000	4320
5.	30,00,000	11,70,000	6480
6	40,00,000	15,60,000	8640

❖ **Interest Rate :**

- Presently, Indian Bank is offering an interest rate of 10 % (fixed) with reset clause once in 5 years and State Bank of India is offering an interest rate of 10.75% pa.
- The interest rates may undergo a change from time to time. Interest rate is subject to change at the end of every five years along with revaluation of security. Every five years, bank may even re-adjust the loan installments, if it is needed, depending on market conditions and loan status

❖ **Security :**

- ✚ Mortgage of residential property in favor of bank. Bank reserves the right to seek additional collaterals on case to case basis.
- ✚ Commercial property is not eligible.

❖ **Period of loan :**

- ✚ 15 years, with a provision to roll over, in case of need, after, revaluation.
- ✚ Fresh terms, as at the time of rollover, will be applicable.

❖ **Repayment terms :**

- ✚ The loan becomes due and payable at the end of the stipulated repayment period or when the last surviving borrower dies, whichever is earlier.
- ✚ Settlement of loan along with accumulated interest to be met, by the proceeds received out of sale of residential property.
- ✚ The borrower/his/her /their legal heirs will have option to settle the loan along with accumulated interest, without sale of property (if required, nomination of legal heirs can be insisted upfront).
- ✚ The loan is not required to be paid back as long as the house owner or his/her spouse occupies his/her property. Borrower need not sell his home, or permanently move out of his home.
- ✚ If the borrower or the spouse dies early (before 15 years), the amount paid to the borrower or his/her spouse will only be recovered, along with interest.
- ✚ Bank may revise the loan eligibility, periodic payment amounts and loan based on re-valuation of property value and prevalent interest rates. Borrower will have the option to accept such revised terms and conditions for

furtherance of the loan. Life certificates to be submitted by borrowers during November each year, as is done for pensioners.

❖ **Pre-payment:**

- ✚ The borrower(s) will have option to prepay the loan at any time during the loan tenor or later.
- ✚ There will not be any prepayment levy/penalty/charge for such pre-payments.

❖ **Insurance and maintenance of property:**

- ✚ Borrower has to insure the property against fire, earthquake and other calamities
- ✚ Borrower is liable to pay property tax or any other taxes leviable on the house
- ✚ Borrower is liable to keep the house in a good condition, pay electricity charges, water charges etc.

❖ **Foreclosure due to occurrence of following events :**

- ✚ If residential property, so mortgaged to the bank is donated or abandoned by the borrower (s).
- ✚ If borrower effects changes in the residential property that affect the security of the loan, for the lender. E.g. Renting out part or the entire house, adding a new owner to the house's title or taking out new debt against the residential property.
- ✚ If Government Agency acquires the residential property for public use. (E.g. To build a highway etc).

❖ **Recession period:**

It is a period stipulating number of days after the transaction is finalized, during which one can cancel the transaction

Know the LAW!!!!

AS 22

The Supreme Court has upheld the revised accounting standards AS 22 issued by the Institute of Chartered accountants of India which has been made mandatory for all the companies listed in the stock exchanges since the financial year 2001-02.

"In the age of globalisation, the attempt is to reconcile the accounts of the Indian companies with their joint venture partners abroad," the 220-page judgment said, and added: "The aim is to harmonize Indian accounting standards with international standards."

Dismissing the appeals of a large number of companies that opposed the new policy, the bench headed by Justice SH Kapadia said AS 22 sought to arrive at the true accounting income.

The main challenge of the companies was to the new concept of deferred tax accounting. They argued that it was inconsistent with the provisions of the Companies Act, the Income Tax Act and the Constitution.

Rejecting this contention, the court said that deferred tax was nothing but accrual of tax due to the divergence between accounting profit and tax profit. This difference arose on two accounts - different treatment of items of revenue or expense according to the profit and loss account and according to the tax law.

It also arose on account of the difference between the amount of revenue or expense according to profit and loss account and the corresponding amount considered for the tax purpose, the judgment explained.

The accounting standard, framed by the institute,

established rules relating to recognition, measurement and disclosures thereby ensuring that all the enterprises that followed them were comparable and their financial statements were true, fair and transparent.

They are based on matching principle and fair value principle, among others. The new concept aimed at a paradigm shift from matching to fair value principle.

Defending the new concept, the Supreme Court stated that the convergence of accounting standards was aimed at removing international barriers in the flow of financial information and capital.

One Person Company

The draft Companies Bill, 2007, has proposed a new entity called a one-person company (OPC) as a measure to provide start-up entrepreneurs and professionals the much-needed flexibility in setting up a business in India.

The onerous compliance requirements that apply to large widely-held companies will not be imposed on such entities.

Officials told that a proposal to this effect has been included in the Bill, which has been sent for inter-ministerial consultation.

The ministry of corporate affairs had said the Bill may be put up for legislative approval in the winter session of Parliament, but officials now say it is unlikely.

"We are waiting for comments from other ministries. After that we will have to seek Cabinet approval and then take it to Parliament," the official said.

The move to permit OPCs in India was recommended by the J J Irani expert committee on revising India's company laws in May 2005.

Various countries permit this kind of a corporate entity (China introduced it in October 2005) in which the promoting individual is both the director and the shareholder.

The principal forms of business organisations permitted in India are sole proprietorship firms (in which only one person runs the business), partnerships (between two or more people) and companies (both private and public where it is

possible for many individuals to own the business by subscribing to its shares).

The fundamental difference between a sole proprietorship and an OPC is the way liability is treated in the latter.

A one-person company is different from a sole proprietorship because it is a separate legal entity that distinguishes between the promoter and his company, said Rajiv Luthra, founder and managing partner, Luthra & Luthra.

Luthra added that the promoter's liability is limited in an OPC in the event of a default or legal issues. On the other hand, in sole proprietorships, the liability is not restricted and extends to the individual and his or her entire assets.

For instance, if a sole proprietorship firm is sued, the promoter also gets sued automatically. In the case of companies, liability is restricted to the shares of a company, except for criminal matters.

"It is a good and highly desirable move, especially as it reduces the level of compliance for OPC's vis-à-vis companies," he said.

The move is expected to ease start-up formalities for prospective entrepreneurs. Similarly, small entrepreneurs who are running their businesses under the proprietorship model could convert to OPCs, with the benefit of limited liability and none of the cumbersome compliance requirements, said corporate law expert Naveen Goel.

Health Check

DRINK WATER ON EMPTY STOMACH

It is popular in Japan today to drink water immediately after waking up every morning. Furthermore, scientific tests have proven its value. We publish below a description of use of water for our readers. For old and serious diseases as well as modern illnesses the water treatment had been found successful by a Japanese medical society as a 100% cure for the following diseases:

Headache, body ache, heart system, arthritis, fast heart beat, epilepsy, excess fatness, bronchitis asthma, TB, meningitis, kidney and urine diseases, vomiting, gastritis, diarrhea, piles, diabetes, constipation, all eye diseases, womb, cancer and menstrual disorders, ear nose and throat diseases.

METHOD OF TREATMENT

1. As you wake up in the morning before brushing teeth, drink 4 x 160ml glasses of water
2. Brush and clean the mouth but do not eat or drink anything for 45 minute
3. After 45 minutes you may eat and drink as normal.
4. After 15 minutes of breakfast, lunch and dinner do not eat or drink anything for 2 hours
5. Those who are old or sick and are unable to drink 4 glasses of water at the beginning may commence by taking little water and gradually increase it to 4 glasses per day.
6. The above method of treatment will cure diseases of the sick and others can enjoy a healthy life.

The following list gives the number of days of treatment required to cure/control/ reduce main diseases

1. High Blood Pressure - 30 days
2. Gastric - 10 days
3. Diabetes - 30 days

4. Constipation - 10 days

5. Cancer - 180 days

6. TB - 90 days

7. Arthritis patients should follow the above treatment only for 3 days in the 1st week, and from 2nd week onwards - daily.

This treatment method has no side effects, however at the commencement of treatment you may have to urinate a few times.

It is better if we continue this and make this procedure as a routine work in our life.

Drink Water and Stay healthy and Active.

This makes sense .. The Chinese and Japanese drink hot tea with their meals ..not cold water. Maybe it is time we adopt their drinking habit while eating!!! Nothing to lose, everything to gain...

For those who like to drink cold water, this article is applicable to you.

It is nice to have a cup of cold drink after a meal. However, the cold water will solidify the oily stuff that you have just consumed. It will slow down the digestion.

Once this "sludge" reacts with the acid, it will break down and be absorbed by the intestine faster than the solid food. It will line the intestine. Very soon, this will turn into fats and lead to cancer. It is best to drink hot soup or warm water after a meal.

A serious note about heart attacks: Women should know that not every heart attack symptom is going to be the left arm hurting. Be aware of intense pain in the jaw line. You may never have the first chest pain during the course of a heart attack. Nausea and intense sweating are also common symptoms. 60% of people who have a heart attack while they are asleep do not wake up. Pain in the jaw can wake you from a sound sleep. Let's be careful and be aware. The more we know the better are our chances of survival.

Congratulations:

**The Lateral Thinking-6 Award is bagged by Miss Monica & Miss Pavitra
Whereas the Logo Quest-2 Award is won jointly by Mr Gopal PL &
Mr. Mukesh Jain**

We congratulate all the winners.

GETTING STARTED WITH AS 16 - BORROWING COSTS

Procurement of the Funds and Effective utilization of the funds is key for success of any business organization. Capital Budgeting and Financing Decision are key decisions for a manager and go hand in hand. Once an organization takes a decision for deployment of funds in a particular project then it has to look for procuring the Funds in such a way that it will lead to maximization of the wealth of the Share Holders. So in case of big turnkey projects financing decision is very crucial managerial decision which will have an impact on the effective running of the project. From the accounting point of view the out flow of the resources in the form of the Interest and other related charges forms a significant part of the total expenses. Accounting Treatments of the Borrowing Costs differ from enterprise to enterprise. Due to dissimilarities in the accounting treatment being adopted in the financial statements of various enterprises in the same line of business, the financial statements are becoming incomparable. Taking into the view the different accounting treatments being adopted ICAI has issued accounting standard-16 “**BORROWING COST**” in the year of **2000** to bring uniformity in the accounting treatment of Borrowing costs.

The effect of differences in accounting treatments of borrowing costs may have an impact on the financial statements only if the recognition of borrowing costs falls in more than one accounting period. There can be a situation where the time lags between “building up of an asset” and subsequent creation of “earnings from the property of an asset” is substantially long. If interest and related borrowing costs were to be expensed in the year in which the expense is incurred (without regard to matching concept), then the following situations can emerge.

- A) In year of “high investments “– profit would drop significantly.
- B) In year of “low investment “– profit would increase.

The objective of the Accounting Standard issued by ICAI is to prescribe the treatment of borrowing cost (interest + other costs) in accounting, whether the cost of borrowing should be included in the cost of assets or not.

Scope: In this backdrop, accounting standard 16 prescribes treatment for borrowing costs, and helps us to:

- Borrowing cost and qualifying asset.
- Appreciate the basis for recognizing borrowing costs.
- Identify the nature of specific and general

borrowings, and treatment of related borrowing costs.

- Appreciate the linkage between carrying amount and recoverable amount of a qualifying asset.
- Ensure when to:
 - Commence capitalization
 - Suspend capitalization
 - Cease capitalization
- Make all the necessary disclosures in the financial statement.

Applicability of AS 16:

The standard **does not apply** to the following

- Actual cost of owners Equity (including preference share capital) or;
- Imputed cost of such Equity
- And such other items forming part of equity and not classified as a liability.

Definitions:

Borrowing Cost: Borrowing costs include interest and other costs incurred by an enterprise in connection with borrowing of funds.

Borrowing costs may include the followings:

- Interest and commitment charges on bank borrowings and other short-term and long-term borrowings.
- Amortization of discounts of premiums relating to borrowings.
- Amortization of ancillary costs incurred in connection with the arrangement of borrowings
- Financing charges in respect of assets acquired under finance leases or under other similar arrangements; and
- Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Qualifying assets: Qualifying asset is an asset that necessarily takes substantial period of time to get ready for its;

- Intended use of fixed assets and investment property in the enterprises
- Sale of inventory in the enterprises

The following are **not qualifying assets:**

- In case of inventories which are manufactured by enterprises in a routine basis.
- In case of inventories, Enterprises which are produced routinely in large scale in a short period of time.
- In case of assets, they are ready for intended use at the time of acquisition.

Recognition:

Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. Other borrowing costs should be recognized as an expense in the period in which they are incurred.

Borrowing costs are capitalized as part of the cost of a qualifying asset when it is probable that they will result in future economic benefits to the enterprises and the costs can be measured reliably.

Specific Borrowings: Specific borrowings are those which could have been avoided, if there is no expenditure on QUALIFYING ASSET. (Amount borrowed is specifically for the purchase of qualifying assets).

General Borrowings: These are those which can't be avoided, even if there is no expenditure on QUALIFYING ASSET.

Amount of borrowing costs eligible for capitalization:

1. Specific borrowings: Borrowing cost to be capitalized = Actual borrowing cost incurred during the period less any income on the temporary investment of borrowed amount.
2. General borrowings: When these are used for the purpose of acquiring a qualifying asset.
 - a. Amount of borrowing cost to be capitalized should be determined by applying a capitalization rate (Cost of capital) to the expenditure on that asset.
 - b. The capitalization rate - weighted average cost of capital.

Linkage between carrying amount and recoverable amount of qualifying asset

The carrying amount of a fixed asset as reflected in the financial statement cannot exceed its recoverable or net realizable value. This principle also includes capitalized element of eligible borrowing costs.

Commencement of capitalization:

The borrowing cost incurred on qualifying asset is to be capitalized only if all the three following conditions are fulfilled-

- ? Expenditure on qualifying asset is being incurred
- ? Borrowing costs are incurred
- ? Activities are in progress; such activities include technical/ administrative work also. However, it does not include those, which do not result in a change in the condition of the asset.

Suspension of capitalization of borrowing cost's

- a. Suspension of activity for avoidable reasons (do not capitalize): Capitalization of borrowing costs should be suspended during extended periods in which active production is interrupted.
- b. Suspension of activity for unavoidable reasons (can continue to capitalize): Capitalization of borrowing costs should not be suspended if there is a temporary delay and where such delay is necessary for getting asset ready. (e.g., maintaining of inventory (wine) and high water level for bridge construction)

Cessation of capitalization of borrowing cost:

- a. It should cease when substantially all the activities necessary to prepare the qualifying assets for its intended use or sale are completed. (borrowing cost incurred thereafter shall be debited to P&L a/c)
- b. When the construction of a qualifying asset is completed in parts and a completed part is capable of being used while construction continues for the other parts, capitalization of borrowing costs in relation to that part should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed. (E.g.: A business park comprising several buildings each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues for the other parts).

Disclosure:

1. the accounting policy followed for treatment of borrowing costs
2. the amount of borrowing costs capitalized during the period

- By Sai Kumar OS

Answers to Logo Quest -3

- 1) Citigo
- 2) Coach
- 3) Coldwell Banker
- 4) DC Shoe co
- 5) Enron
- 6) Gateway
- 7) Girl Scouts

- 8) Hallmark
- 9) Microsoft Office
- 10) Mr. Clean
- 11) Sprint
- 12) UNICEF
- 13) United States Postal Service
- 14) United Way
- 15) Verizon

Logo Quest - 3

- Rayan Sequeira

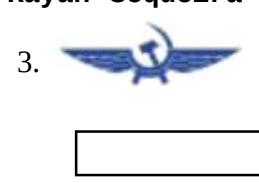
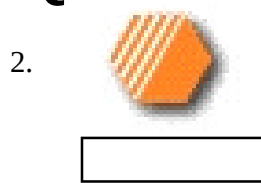
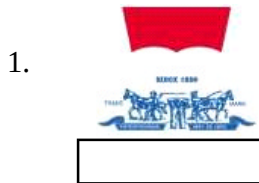


Figure out the above "Logos" and Mail it across to us at newsletter@dnsconsulting.net

The Last date for the submission of your Answers is 25th December.

Answers will be published in the next edition of "The Articled"

General Insights IN A NUTSHELL:

Closings on 5th December 2007

Assets under Management

Company	AUM (in Crores)
Reliance	77764.84
ICICI Prudential	54952.21
UTI	52179.79
HDFC	46751.86
Birla Sun Life	31388.84
Franklin Templeton	31046.51
SBI	27359.60
Kotak Mahindra	21719.28
Tata	21320.15
DSP Merrill Lynch	20960.48
HSBC	16846.58
Principal	14782.42
Standard Chartered	14303.73
LIC	13437.67
Deutsche	12570.50
Sundaram BNP Paribas	11650.29

Markets:

Sensex	19529.50
Nifty	5858.35
Dow	13245.15
FTSE	6299.00
Nasdaq	2616.10
Nikkei	15480.19

Rates:

Rs/Dollar	39.42
Rs/Pound	81.35
Rs/Euro	58.11

Crude:

Brent	\$90.17
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Bullion:

99.9 Purity Gold:	Rs. 10621
Silver (Kg):	Rs. 20300

Write to The Editor

"Continuous learning process" is the essence of our profession. To keep ourselves in pace with the emerging concepts is what we have endeavor through this "The Articled". We also intend to build this into a common knowledge-sharing platform and welcome any contributions to strengthen this common pool. Your views will help us fortify the forthcoming issues. You can mail us at newsletter@dnsconsulting.net or write to: The Editor, #10, South Park Road, Nehru Nagar, Sheshadripuram, Bangalore - 20.

Business Cartoon

Investments and Financial Planning



"I retire on Friday and I haven't saved a dime. Here's your chance to become a legend!"

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