

CASE STUDY 5

ABCD Ltd. is a textile manufacturing company based in Surat, Gujarat, which enjoys a vintage of more than 50 years of good reputation and business. The Company was set up by Mr. Amar Dev in the 60's in a small room and as years passed by, it became such a successful and big business that now after serving domestic consumers, the Company has gone global and expanding its business across Europe and Canada through third party sales from India. Mr. Rahul Dev, grandson of Mr. Amar Dev is Managing Director of Company and has been following quite an aggressive approach in globalizing their business after graduating from college. He remains in constant touch with CA Nitin Garg, partner of Nitin Garg & Co., Chartered Accountants, and keeps on discussing with him legal compliances and procedures.

Rahul knows that the complexities in business have increased a lot particularly after advent of GST and it is imperative to diversify the ever-expanding businesses. He understands that their company is well integrated into the web of international business transactions. There is inward as well as outward flow of goods and services between India and other countries. GST impacts imports and exports too. Provisions in the GST laws seek to (i) provide a level playing field to domestic suppliers vis a vis international suppliers in case of imports and (ii) make exports more competitive. He has been discussing various provisions of GST law as will be applicable on import and export supplies w.r.t. their business, if they wish to enter the global market directly, apart from the normal customs levy.

To expand the business, Rahul is in talks with Robert de Nero, one of his fast friends whom he met during his graduation in London and who is currently the owner of a famous International Clothing Brand "ALPHA". Robert wants to establish a company in India and seeks Rahul's help who further consults CA Nitin on helping Robert set up a branch office in India. Robert's venture – ALPHA Units LLC is a limited company incorporated in London in the year 2011, and he desires to establish a branch office at Surat in the year 2023.

Nitin, being a practicing Chartered Accountant, is appointed by Robert as a liaison officer for compliance of legal formalities on behalf of the company. Nitin helps them in the legal compliance, research, feasibility, documentation and procedural work to set up branch office in India. Rahul, in order to expand his business, discusses with Nitin on setting up a subsidiary outside India at Paris for specifically carrying out the Import-Export transactions easily and soon afterwards Rahul sets up a subsidiary at Paris under the name & style of PQRS Ltd.

ABCD Ltd. is engaged in the business of manufacturing cloth for other textile companies and non-textile companies. Now the company will be itself carrying out the Import-Export transactions without involving any 3rd Party for export purposes which it had been doing till now. It applies for the IEC – Importer Exporter Code online and gets the same. Its wholly owned subsidiary, PQRS Ltd., is engaged in the business of readymade designer garments. The subsidiary purchases garments and other stuff from its parent company. The demand for garments of PQRS Ltd. is very high and hence to cater to its shortfall, PQRS Ltd also purchases garments from other companies. Purchases are made at competitive prices. During the year 2023-24, ABCD Ltd sold garments to PQRS Ltd for Euro 13 lakhs on 1st January, 2024. The cost of these garments was ₹ 936 lakhs in the books of ABCD Ltd at the time of sale. At the year-end i.e., 31st March 2024, all these Garments were lying as closing stock with PQRS Ltd. Euro is the functional currency of PQRS Ltd. while Indian Rupee is the functional currency of ABCD Ltd.

ABCD Limited seeks help from CA Nitin on the following issues: -(a) During the year, Rahul is finding it difficult to comprehend the GST taxation w.r.t. export sales made by their company, ABCD Ltd., which are of a peculiar nature. One such sale is where ABCD Ltd. receives an order to supply goods to a dealer 'B' in Greece. The company finds a supplier 'C' in Singapore and asks him to supply goods to 'B' in Greece. Two invoices are raised here: one by the company on 'B' in Greece and the other by 'C' in Singapore on ABCD Ltd. in India. The point to be noted here is that goods do not touch the Indian shores; they are shipped by 'C' from Singapore to 'B' in Greece. There are many more, such kind of export sales and Rahul seeks CA Nitin's help in getting out of this confusion.

(b) Rahul seeks CA Nitin's opinion on the GST procedures and treatment for the following two types of export transactions which he plans to proceed with in near future: -

- Rahul has purchased a license to put up a stall in the Textile Supermarket Global Fair to be held at Milan, Italy and he wishes to send his team to this fair along with their company's merchandise to be displayed over there for promotional purposes.
- He had heard from a dear friend that he could sell his company's products within India but these could still be categorized as exports. He was eager to know about such circumstances.

(c) The Chief accountant of the Company further seeks CA Nitin's time to understand about the valuation & taxability of the following transactions under GST:-

- ABCD Ltd. has imported a special fabric from Paris and files an ex-bond bill of entry for clearing such warehoused goods for home consumption.

- ABCD Ltd. imported textile fabric from London and sells them to a Panacea Pvt. Ltd. in India itself before the goods are cleared for home consumption. The customs declarations i.e. bill of entry etc. is filed by the agent of Panacea Pvt. Ltd. for clearance of such goods.

The Statutory audit of the company ABCD Ltd. is also being carried out by Nitin Garg & Co. under the supervision of the Engagement Partner CA Krit Garg. CA Krit understands that as the auditor, he should develop an audit plan that shall include a description of the procedures to be performed as per SA 315 & 330. The audit plan is more detailed than the overall audit strategy that includes the nature, timing and extent of audit procedures to be performed by engagement team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the engagement develops. He asks Megha in his audit team to work on planning the nature, timing and extent of specific further audit procedures and Saurab on planning of risk assessment procedures. Further, CA Krit knows that the overall audit strategy & audit plan should take into consideration the element of materiality and its relationship with Risks & procedures to be adopted CA Krit has already developed an audit strategy and while a detailed audit plan is being developed, he decides that materiality levels set earlier need to be lowered as weaknesses in the internal controls were highlighted in the internal audit reports. Subsequently, a deviation from the audit strategy is felt necessary and he is stuck in a dilemma as what to do first – modify the audit strategy and then revise the audit plan or vice-versa and seeks his Partner CA Nitin's suggestion.

I. Multiple Choice Questions

1. Which of following is responsible for issuing/granting IEC (Importer Exporter code)?
 - (a) Customs under Department of Revenue, Ministry of Finance
 - (b) Directorate General of Foreign trade (DGFT), Ministry of Commerce and Industry
 - (c) Department for Promotion of Industry and Internal Trade (DPIIT)
 - (d) Ministry of Corporate Affairs (MCA)
2. What should CA Nitin advise CA Krit to do when the latter is stuck in the revision dilemma of materiality levels set earlier?
 - (a) Firstly, modify the overall strategy and thereafter, prepare the audit plan in line with the strategy.
 - (b) Firstly, prepare the audit plan and then modify the overall audit strategy in line with the Plan.
 - (c) Modify the Audit Plan and Strategy simultaneously.
 - (d) Go with change in anyone, as these are not inter-related.

3. STATEMENT 1:- GST is leviable on the fabric imported from Paris while filing for its clearance.

STATEMENT 2:- GST is not leviable on the sales made to Panacea Pvt. Ltd.

- (a) Statement 1 is Correct but statement 2 is Incorrect.
(b) Both the statements are Correct and independent of each other.
(c) Statement 2 is Correct & Statement 1 supports Statement 2.
(d) Statement 1 is Correct but Statement 2 is Incorrect.
4. In the above case, Robert de Nero's branch office in India proposes to offer subscription to securities of Alpha Units LLC. Before going with the subscription, , it would be necessary to: -

STATEMENT 1:- file a prospectus dated and signed.

STATEMENT 2:- the prospectus shall the date on which and the country in which the company was incorporated

- (a) Both the statements are Correct.
(b) Both the Statements are Incorrect.
(c) Statement 1 is Correct while Statement 2 is Incorrect.
(d) Statement 1 is Incorrect while Statement 2 is Correct.
5. STATEMENT 1 :- In case of trade involving 'B' in Greece and 'C' in Singapore, invoicing should not have been done by ABCD Ltd. in India.

STATEMENT 2 :- Value of such shipments has to be included by ABCD Ltd. in the value of exempt supply for the purpose of reversal of ITC under rules 42 and 43 of CGST Rules.

- (a) Statement 1 is Correct & Statement 2 supports Statement 1.
(b) Both the Statements are Incorrect.
(c) Statement 2 is Correct & Statement 1 supports Statement 2.
(d) Statement 1 is Incorrect but Statement 2 is Correct.

II. Descriptive Questions

6. Provide the accounting treatment w.r.t. transaction between ABCD Ltd. and PQRS Ltd. in their respective books of accounts. Also show its impact on consolidated financial

Reason: As per provisions of section 387 (1) of Companies Act, 2013, no person shall issue any prospectus offering to subscribe for securities of a company incorporated outside India unless the prospectus is dated and signed. Besides, it should also contain the date on which and the country in which company was incorporated.

5. (b) Both the Statements are Incorrect.

Reason: Third country shipments or triangular trade is a common practice in international trade whereby goods move from one country to another without touching India; only invoicing is done by the registered person in India. Paragraph 7 of the Schedule III to CGST Act provides that supply of goods from a place in the non-taxable territory to another place in the non-taxable territory without such goods entering into India (third country shipments) is treated neither as a supply of goods nor a supply of services. Thus, there is no GST liability on such sales. Further, value of such third country shipments is not included in the value of exempt supply for the purpose of reversal of ITC under rules 42 and 43 of CGST Rules [Explanation to section 17(3) of the CGST Act].

II. Answers to the Descriptive Questions

6. Accounting treatment in the books of ABCD Ltd (Functional Currency ₹)

ABCD Ltd will recognize sales of ₹ 1079 lakhs (13 lakhs Euro x 83)

Profit on sale of Inventory = 1079 lakhs – 936 lakhs = ₹ 143 lakhs.

On balance sheet date receivable from PQRS Ltd. will be translated at closing rate i.e. 1 Euro = ₹ 85. Therefore, unrealised forex gain will be recorded in standalone profit and loss of ₹ 26 lakhs. (i.e. (85 - 83) x 13 Lakhs)

Journal Entries

		₹ (in Lakhs)	₹ (in Lakhs)
PQRS Ltd. A/c	Dr.	1079	
To Sales			1079
(Being revenue recorded on initial recognition)			
PQRS Ltd. A/c	Dr.	26	

To Foreign exchange difference (unrealised)		26
(Being foreign exchange difference recorded at year end)		

Accounting treatment in the books of PQRS Ltd. (Functional currency EURO)

PQRS Ltd will recognize inventory on 1st January, 2024 of Euro 13 lakhs which will also be its closing stock at year end.

Accounting treatment in the consolidated financial statements

Receivable and payable in respect of above-mentioned sale / purchase between ABCD Ltd and PQRS Ltd will get eliminated.

The closing stock of PQRS Ltd will be recorded at lower of cost or NRV.

	Euro (in lakhs)	Rate	₹ (in lakhs)
Cost	13	83	1079
NRV (Assumed Same)	13	85	1105

Therefore, no write off is required. The amount of closing stock of ₹ 1079 includes two components–

Cost of inventory for ₹ 936 lakhs; and Profit element of ₹ 143 lakhs; and

At the time of consolidation, the second element amounting to ₹ 143 lakhs will be eliminated from the closing stock.

Journal Entry

		₹ (in Lakhs)	₹ (in Lakhs)
Consolidated P&L A/c	Dr.	143	143
To Inventory			
(Being profit element of intragroup transaction eliminated)			

7. (i) **According to section 2(42) of the Companies Act, 2013**, “Foreign company” means any company or body corporate incorporated outside India which-
- has a place of business in India whether by itself or through an agent, physically or through electronic mode; and
 - conducts any business activity in India in any other manner.

Further, branch offices are generally considered as reflection of the Parent Company's office. Thus, branch offices of a company incorporated outside India are considered as a place of business for conducting business activity in India and will be required to follow provisions of Chapter XXII and such other provisions as may be specified elsewhere under Companies Act, 2013.

(ii) **Under section 380(1) of the Companies Act, 2013** every foreign company shall, within 30 days of the establishment of place of business in India, deliver to the Registrar for registration the following documents:

- (a) a certified copy of the charter, statutes or memorandum and articles, of the company or other instrument constituting or defining the constitution of the company. If the instruments are not in the English language, a certified translation thereof in the English language;
- (b) the full address of the registered or principal office of the company;
- (c) a list of the directors and secretary of the company containing such particulars as may be prescribed;

In relation to the nature of particulars to be provided as above, the *Companies (Registration of Foreign Companies) Rules, 2014*, provide that the list of directors and secretary or equivalent (by whatever name called) of the foreign company shall contain the following particulars, for each of the persons included in such list, namely:

- (1) personal name and surname in full;
- (2) any former name or names and surname or surnames in full;
- (3) father's name or mother's name and spouse's name;
- (4) date of birth;
- (5) residential address;
- (6) nationality;
- (7) if the present nationality is not the nationality of origin, his nationality of origin;
- (8) passport Number, date of issue and country of issue; (if a person holds more than one passport then details of all passports to be given)

- (9) income-tax permanent account number (PAN), if applicable;
 - (10) occupation, if any;
 - (11) whether directorship in any other Indian company, (Director Identification Number (DIN), Name and Corporate Identity Number (CIN) of the company in case of holding directorship);
 - (12) other directorship or directorships held by him;
 - (13) Membership Number (for Secretary only); and
 - (14) e-mail ID.
- (d) the name and address or the names and addresses of one or more persons resident in India authorised to accept on behalf of the company service of process and any notices or other documents required to be served on the company;
 - (e) the full address of the office of the company in India which is deemed to be its principal place of business in India;
 - (f) particulars of opening and closing of a place of business in India on earlier occasion or occasions;
 - (g) declaration that none of the directors of the company or the authorised representative in India has ever been convicted or debarred from formation of companies and management in India or abroad; and
 - (h) any other information as may be prescribed.

According to the Companies (Registration of Foreign Companies) Rules, 2014, any document which any foreign company is required to deliver to the Registrar shall be delivered to the Registrar having jurisdiction over New Delhi.

- 8. Export of goods or services are treated as inter-State supply and zero rated.** This means that even if there is full exemption for the supply, ITC is still available to the exporter. The exporter will have an option to either pay IGST on the outward supply and claim refund of such IGST paid or export under Bond/LUT without payment of IGST and claim refund of ITC. The objective is to make Indian exports competitive in the international market. It may be noted that since exports are inter-State supplies, the tax associated with them will always be IGST.

- (a) Rahul has purchased a license to put up a stall in the Textile Supermarket Global Fair to be held at Milan, Italy and he wishes to send his team to this fair along with their company's merchandise to displayed over there for promotional purposes.

= Sending/ taking goods out of India for exhibition or on consignment basis for export promotion: Circular No. 108/27/2019 GST dated 18.07.2019 has clarified that the activity of sending/ taking goods out of India for exhibition or on consignment basis for export promotion, except when such activity satisfy the tests laid down in Schedule I of the CGST Act, does not constitute supply as the said activity does not fall within the scope of section 7 of the CGST Act as there is no consideration at that point in time. Since such activity is not a 'supply', the same cannot be **considered as "zero rated supply" as per the provisions contained in section 16 of the IGST Act**. Thus, activity of sending/ taking specified goods out of India is not a zero-rated supply. That being the case, execution of a bond or LUT, as required under section 16 of the IGST Act, is not required.

- (b) He had heard from a dear friend that he could sell his company's products within India and these still can be categorized as exports..

It takes place in deemed exports. Deemed exports refers to supplies of goods manufactured in India (**and not services**) which are notified as deemed exports under section 147 of the CGST Act. Such supplies do not leave India and the payment for the same is received either in Indian rupees or in convertible foreign exchange.

Following categories of supply of goods have been notified as deemed exports by the Government vide Notification No. 48/2017 CT dated 18.10.2017, -

- (a) Supply of goods by a registered person against Advance Authorisation (AA)
- (b) Supply of capital goods by a registered person against Export Promotion Capital Goods Authorisation (EPCG)
- (c) Supply of goods by a registered person to Export Oriented Unit (EOU)
- (d) Supply of gold by a bank or Public sector Undertaking specified in Notification No. 50/2017 Cus dated 30.06.2017 (as amended) against AA

Taxability of deemed exports

Deemed exports are not zero-rated supplies by default, unlike the regular exports. Hence, all supplies notified as supply for deemed export are subject to levy of taxes, i.e. such supplies can be made on payment of tax and cannot be supplied under a Bond/LUT.

However, the refund of tax paid on the supply regarded as deemed export is admissible to either the supplier or the recipient. Thus, the application for refund has to be filed by the supplier or the recipient (subject to certain conditions) of deemed export supplies, as the case may be.