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.

ABCD Limited wants to expand its business and management has found a suitable site which meets its requirements. The said site is owned by one of directors of company i.e. Mr. D. However, Mr. D was unwilling to sell his prized property to the company. The company, however, offers him, in exchange, a bigger site located in an area having commercial potential. Lured by offer, Mr. D agrees to above. A property valuer (Civil engineer by profession) who is having experience of 20 years in valuing properties for commercial banks is also approached by company for arriving at value of assets involved in above deal. The valuer does not possess any other registrations or accreditations.

Rahul, in order to expand his business, also 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

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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 'Ç' 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 'Ç' 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.

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- 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.

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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. Considering transaction with Mr. D, one of the directors of company, which of following statements is most appropriate?

   (a) The transaction with Mr. D is permissible subject to certain conditions laid down in Companies Act, 2013. However, the company is not acting in accordance with law by approaching a valuer referred to in the description. Such a valuer needs registration from The Institute of Actuaries of India to act as valuer.

   (b) The transaction with Mr. D is permissible subject to certain conditions laid down in the Companies Act, 2013.The company is acting in accordance with law by approaching a valuer referred to in the description.

   (c) The transaction with Mr. D is permissible subject to certain conditions laid down in the Companies Act, 2013. However, the company is not acting in accordance with law by approaching a valuer referred to in the description. Such a valuer needs registration from Insolvency and Bankruptcy Board of India to act as valuer.

   (d) The transaction with Mr. D is permissible subject to certain conditions laid down in Companies Act, 2013. However, the company is not acting in accordance with law by approaching a valuer referred to in the description. Such a valuer needs registration from The Institution of Engineers (India) to act as valuer.

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.

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(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 statements. Support your answer by Journal entries, wherever necessary, in the books of ABCD Ltd.

   Following additional information is available:

Exchange rate on 1st January, 2024	1 Euro = ₹ 83
Exchange rate on 31st March, 2024	1 Euro = ₹ 85

7. As regards transaction with Mr. D, one of the directors, state few audit procedures pertaining to transaction to be performed by CA Krit Garg. Discuss probable purpose of such audit procedures also.

8. Discuss implications of proposed transaction relating to sending of company's merchandise for display in textile fair in Italy. Also discuss under what circumstances goods sold within India can still be categorized as exports under GST law and also touch upon taxability of such transactions under such law.

ANSWERS TO THE CASE STUDY 5

I. Answers to the Multiple Choice Questions

1. **(b)** Directorate General of Foreign trade under Ministry of Commerce and Industry is responsible for granting IEC.

2. **(a)** Firstly, modify the overall strategy and thereafter, prepare the audit plan in line with the strategy.

Reason: CA Krit should firstly modify the overall strategy and thereafter, prepare the audit plan in line with the strategy. This shows that the audit strategy and audit plan are closely inter-related as change in one is resulting into change in the other.

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3. **(b)** Both the statements are Correct and independent of each other

Reason: GST is not leviable when goods deposited in customs bonded warehouse are sold before clearance; the same is leviable when ex-bond bill of entry is filed for clearing such warehoused goods for home consumption. GST is not leviable on high sea sales (the sales made to Panacea Pvt. Ltd.).

4. **(c)** The description provided in case study is an example of non-cash transactions with directors of company. Such transactions are governed under section 192 of Companies Act, 2013. The company can undertake such transactions after fulfillment of conditions prescribed under section 192 of Companies Act, 2013 like prior approval of such arrangement in general meeting accorded by a resolution. Further, notice of such resolution also needs to indicate value of assets involved in such an arrangement calculated by a registered valuer. Such a valuer needs qualifications and experience as described in section 247 and relevant rules and needs registration from Insolvency and Bankruptcy Board of India (IBBI) to act as valuer. The valuation examination is also conducted by IBBI.

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.

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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.

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Journal Entry

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

7. The transaction with Mr. D, director of company, is in nature of non-cash transactions referred to in section 192(1) of Companies Act, 2013. Few audit procedures in this regard include: -

(i) Obtain management representation as to whether the company has undertaken any non-cash transactions with the directors or persons connected with the directors, as envisaged in section 192(1) of the Companies Act, 2013. The auditor would need to corroborate the management representation with sufficient appropriate audit evidence. Reference can be made to minute books, movements in PPE register of company, and relevant registers/records.

(ii) The auditor should check compliance with section 192(2) of the Companies Act, 2013 and verify the notice of the general meeting that it includes particulars of arrangement along with the value of the assets involved in such arrangements.

(iii) The said value of assets should be calculated by the registered valuer in compliance of Companies (Registered Valuers and Valuation) Rules, 2017.

The purpose of performing such audit procedures could be reporting requirement for non-cash transactions under clause (xv) of Paragraph 3 of CARO, 2020. The said clause requires the auditor to report whether the company has entered into any non-cash transactions with directors or persons connected with him and if so, whether the provisions of section 192 of Companies Act have been complied with.

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.

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(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

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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.

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