Case Studies for Group Discussion on 2-March-2024

Question 1 - Membership Fee

The business model of Lakshadweep Holidays is to collect 100% membership fees upfront for a membership of 20 years. The membership holder would be allowed 7 free nights every year in Lakshadweep Properties located across India. If the membership holder doesn't utilize the free nights in a particular year, then the same lapses.

The membership fee is contractually split into two separate components:

i. Admission Fee: Being 30% of the membership fees, which is non-refundable, for enrolling into the Lakshwadeep Holidays Membership.

ii. Entitlement Fees: Being 70% of the membership fee for the services that the member is entitled to in the future.

The management of Lakshadweep Holidays seeks your view on the following points:

Accounting

1. How will the income from admission fees and entitlement fees be recognised in the books of account as per AS-9?

GST

1. Whether GST would be payable upfront on entire value on receipt of advance

2. What is the location of supply as resorts are spread across India

3. Whether the resort will be able to claim ITC of the expenses incurred by it on developing the property and other operating expenses in the State where the resort is located

Tax

1. Recognition of revenue for tax purpose and its interplay with ICDS

2. Assuming TDS was deducted on entire sum by the member, how would Lakshwadeep Holidays claim credit of same

Question 2 - Foreign Subsidiary vis-a-vis Joint Venture

Alternative Meals Company Inc. (AMC) is incorporated in the USA into the business of QSR (Quick Service Restaurant) under the brand name Quack Donalds. It is planning to enter into a joint venture agreement with King Circle Foods Pvt. Ltd. (KCF), incorporated in India, to establish and operate QSRs across India under its brand name Quack Donalds.

AMC and KCF will jointly incorporate a company called QuackD India Pvt. Ltd. (QcD), wherein they will have 50% shareholding each (shares at a premium of Rs 100 each). The recipe for all the meals, quality standards, store layout, branding and marketing will be developed and decided by AMC, whereas the store locations, staffing and daily running of the restaurants will be handled by KCF.

KCF is also into agro business and will be providing vegetables, grains and other raw materials, etc. required for the restaurants, as per the quality standards prescribed and approved by AMC. These ingredients will be given by KCF at a cost of 20% less than the market rate of the goods and these goods will be delivered directly to the store locations.

QcD will pay a royalty of 5% of the sales made by them to AMC for using the brand name which is owned by AMC. The branding content including the colour scheme, logos, layouts etc. will be given by the Head Office of AMC situated in San Francisco. AMC Inc, will also charge QcD for any global marketing and branding activities done by them.

QcD will also establish an R&D centre in Bengaluru which will research and develop new ingredients and recipes. Any recipe or ingredients developed at this centre will be owned by AMC and AMC will have the right to use them in any of its QcD restaurants in the world, including India. AMC will pay QcD the entire cost incurred by QcD in running and establishing the centre plus a 15% margin.

QcD and AMC Inc. will settle their accounts for the royalty, global marketing and R&D Centre charges on a quarterly basis and either party will remit the other payable amount. Only the net amount arrived at the end of the quarter will be remitted by either of the parties.

Now, QcD has approached you with the following queries:

GST:

1. Answer the following after considering the flow of money between AMC and QcD:
- What will be the taxability of the royalty and marketing costs paid by QcD to AMC;
- Whether the service provided by the R&D centre developed by QcD will be eligible for Export benefits under GST

2. Would your answer remain the same had QcD been only a branch of AMC instead being a subsidiary of AMC with a third person.

3. Can QcD claim ITC of the GST paid by it on the royalty, marketing expenses and ingredients purchased by it.

4. Can the consideration charged by KCF for the raw materials / ingredients be challenged by the GST Department.

5. Royalty and Global marketing expenses are paid and borne by the Head Office in Mumbai whereas the restaurants are spread across India. Will there be any implications under GST for the same? Are there any recent changes in the same? Discuss.

Income Tax:

1. What precautions and compliance QCD needs to take while making royalty payments to AMC

2. Subscription of shares at premium - whether would have any tax implications for AMC, KCF or QCD. Will your answer change, if the share subscription had happened in March 2022.

3. Whether there could be any implications u/s 40A(2)(b) for payments made to KCF

4. Discuss the applicability and implication of transfer pricing provisions with reference to the royalty payment and R&D research recovery. Also discuss whether QCD should apply for safe harbour provisions.

Accounts

1. Will the accounts of QcD be consolidated? If yes, then will the consolidation be done with the accounts of KCF or AMC?

2. Which transactions will be reported under Related Party Transactions in the financial statements of QcD as per AS-18?

Question 3 - Real Estate Activity and Redevelopment of Pagri Building

Naresh had a flat in an old and dilapidated Pagri building . ABC Private Ltd., a construction company, was interested in redeveloping the building. ABC Private Ltd. was also interested in making a commercial complex on the lower floors of the proposed structure.

ABC Private Ltd. gave an offer to Naresh that he will get a flat on ownership basis with an additional 35% area. Naresh has also negotiated with the builder for acquiring a further additional area of 30% for which he will be required to pay consideration which has been mutually agreed at 20% less than the prevailing stamp duty ready reckoner rate. In addition, Naresh will also be receiving the following payments:

- Hardship compensation of Rs. 10 Lakhs for the difficulty created due to vacating the existing premises, moving into new rental premises, etc.
- Corpus Fund of Rs. 12 Lakhs for covering the increased maintenance of the new flat.
- Rent of Rs. 60 thousand per month for the next 36 months. Mr. Naresh does not plan to acquire any premises on rent and will move into another flat already owned by him and which was on rent for some time.

The entire project was awarded to a specialised contractor for a lump sum cost of Rs. 50 crores plus GST. While the contractor is responsible for overall execution of the project, the contract does provide for milestone payments based on various milestones being achieved.

From the above facts, issues for discussion are as follows:

1. What is the accounting treatment in the books of ABC Private Ltd. as per Accounting Standards and Guidance Note on Real Estate Transaction - For payment of Rs. 50 crores to the new contractor

2. Will the accounting treatment change if ABC Ltd. was a listed company and was falling under Ind-AS regime?

3. What will be the Income Tax implication on ABC Private Ltd. for above mentioned transactions?

4. What would be the Income tax & TDS implications for Naresh for all the three payments which ABC Private Ltd. has agreed to pay?

5. What would be Income tax and GST implication on Relinquishment of tenancy rights by Naresh to ABC Private Ltd.

6. Whether input tax credit can be claimed by ABC Private Ltd. of the GST charged by the new contractor
for construction of building?

Question 4 - Non-payment of dues

Songbird Airlines Ltd. owned by Mr. Samit Modi is in the business of operating domestic and international flights on the routes sanctioned to them by DGCA. They have taken their flights on lease from airline manufacturers. They are also liable to pay certain airport usage fees and aviation fuel charges at the airports from where they operate.

Normally, passengers pay the ticket fare a few months in advance from the actual journey date. Songbird also avails various on ground services from local MSME suppliers.

Off late, the airline is facing financial difficulties and therefore, is unable to meet its financial obligations. Due to these constraints, it is unable to pay for the airport usage charges and aviation fuel and also for the lease of the planes, this has led to severe cancellations in the flights. This has led to several refund claims from passengers who have paid the fare in advance. Also, it is unable to pay the on ground service providers at the airports.

This has led to DGCA to initiate inquiry into the operations of the airlines, including parallel investigations from ED which has led to freezing of the bank accounts of the company further hampering their ability to repay their dues and restart their operations.

In light of the above, please analyse the following:

1. Whether the auditor should report on the ability of the company to continue as a going concern? What are the requirements / criteria for a company to be termed as a 'Going Concern'?

2. What are the implications of non-payment to the vendors under the various provisions of Income tax Act, Auditing requirements and GST law?

3. Due to their lack of ability to make payments, the company is also behind on their compliances in filing GST returns and neither have they been able to finalise their books of accounts and hold their AGM, and have not been able to file their Income Tax Return. Discuss the various implications of these non-compliances under the various domains.

4. During the ED investigation, the promoter Mr. Modi has been found guilty of misappropriation of company funds and has been arrested for his crimes. Whether the Auditor and his team be held guilty for failing to flag the red flags in the company at the right time.

Question 5 - Bogus Purchase

ABC limited a listed Company is engaged in manufacturing and trading of casting products. It had taken huge borrowings from banks for funding its business operations. Due to steep increase in the commodity prices and government tax policies, the turnover of the Company had seen substantial reduction. In order to maintain a suitable credit score for banking relation, retain investor confidence, it was advised by Mr. Chatur (Banker to ABC Limited) to indulge in bogus purchase and sale transactions to increase the turnover. During the course of assessment proceedings at XYZ Limited, the Director of XYZ limited admitted to entering into a bogus transaction with ABC Limited.

Based on the admission of the director of XYZ limited, a reassessment proceedings were initiated against ABC Limited (beyond 3 years from the relevant assessment year), wherein it is proposed to disallow the entire purchase from XYZ Limited for income tax purpose. The said information was shared by the Income tax department to GST department for taking further actions.

The management of ABC Limited seeks your view on following issue:

Accounting

1. If the addition made by the tax department is sustained – how will the same be recorded in the books of ABC Limited. Is there a requirement for an auditor to report such transaction in its Audit Report?

2. Can the Company revise its financials which have been adopted in AGM to give impact of bogus purchase issue.

GST

3. Whether GST ITC Credit would be disallowed on bogus purchase

4. GST output liability on sales corresponding to bogus purchase whether would also be reversible?

5. Whether any penalty would be payable under GST law.

6. Discuss the period of limitation under GST law and advise the company as to the period till which the GST department can issue notice for recovery of the tax not paid / ineligible input tax credit

Tax

7. Whether re-assessment proceedings based on the admission of XYZ Limited would be valid in law?

8. Whether tax department is right in disallowing the entire purchase but not disregarding the corresponding sales? Whether addition should be restricted to average gross margin of ABC Limited

9. The proposed additions would be taxed at what rate and under which section

10. Whether any penalty would be payable under Income tax law.