



Due Diligence Reviews – Indirect tax perspective

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Contents



- Due diligence, expectations
- Key aspects
- Usual observations
- Unusual observations
- How to conclude
- Other points to note

This presentation is prepared merely for informational purposes only.

Due Diligence Reviews – Indirect Tax perspective

EXPECTATIONS



Due diligence, expectations

- Due diligence reviews typically sit between an audit and an investigation
- For indirect tax matters, diligence reviews aim to reduce ambiguities and contingencies into specific "yes/ no" statements on exposure
- Ideal expectation is to convert all subjective observations into objective comments through combination of jurisprudence and practical experience
- Time-bound assignment leaves limited room to research or contemplate alternatives

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KEY ASPECTS



Key aspects

- Internal control of indirect taxes
- Status and health of critical indirect tax compliances
- Company policy on adopting tax positions (how aggressive or conservative)
- Industry practice v/s outlier approach towards positions, processes or documentation
- Whether indirect tax returns match with audited financials (oftentimes they don't, and the reasons could be an observation by itself)
- Commenting on gaps between Target v/s Buyer's positions

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USUAL OBSERVATIONS

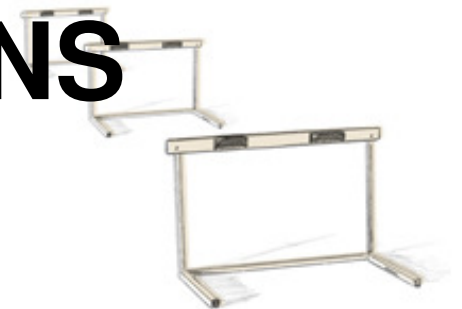


Usual observations

- Reconciliation gaps between audited financials and indirect tax returns
- Lack of adequate documentation
- Inconsistencies between positions advocated v/s positions actually adopted
- Differences on account of estimates for tax provisions
- CENVAT/ State-VAT credit accounting
- Procedural inconsistencies such as end-use conditions for exemption not met, etc
- Slump sale v/s itemized sale

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UNUSUAL OBSERVATIONS



Unusual observations – some examples

Banking & Financial Services

- Non-compliance under State-VAT laws
- Margin transactions and their treatment under service tax
- Method of identifying and reversing CENVAT credits

Logistics

- Gross v/s net revenue recognition methods
- "Nominated business" transactions and reverse charge
- Discount v/s brokerage v/s subvention

Unusual observations – some examples

Auto/ Industrials

- Excise valuation
- Contract manufacturing v/s jobwork
- State incentives and its consequent effect

International trade

- Applicability of Foreign Trade Policy schemes
- Mid-term changes in business models v/s schemes
- Accounting for potential trade benefits

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HOW TO CONCLUDE



How to conclude

Recognizing effect of "high" v/s "medium" v/s "low"

- High: Valuation adjustment & Business Transfer Agreement
- Medium: Representations and Warranties to be updated, discretion to be exercised for valuation adjustments
- Low: General Representations and Warranties should have mention

Estimating "net" impact

- Remember to adjust tax credits against estimated liabilities
- Interest to be computed upto date of actual transfer

How to conclude

Suggest alternative remedies for existing litigation

- Settlement Commission or Advance Ruling, as per case
- Where matter is "fait accompli" suggest foreclosure
- Rectification of procedural matters prior to transfer

Principle of Conservatism

- At all times, reviewer should exercise "conservatism"
- Where alternative views exist, to adopt the conservative view or the most logical outcome

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OTHER POINTS TO NOTE



Other points to note

- Indirect tax Report is a sub-set of overall Diligence Report
- Consistency of language, philosophy on positions taken, manner of estimation, etc is crucial
- Where possible, quantify observations
- Where quantification not possible, provide basis to quantify
- Be prepared to have each observation challenged, especially by the Target Company
- Indirect tax specialists to be part of initial kick-off meeting

MOST IMPORTANT: KNOW THE TARGET'S BUSINESS!!!

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