CMA Students Newsletter (For Final Students)

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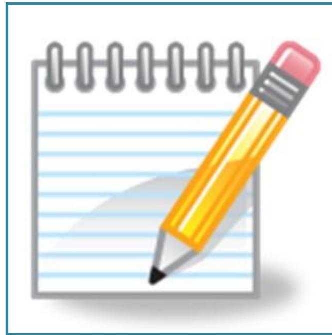
MINUTES



The statutory requirements relating to preparation of minutes, as contained in section 118, are as follows:

(A) PROVISIONS CONTAINED IN THE ACT

Every company shall cause to be prepared, signed and kept minutes of –

(i) Proceedings of every general meeting
(ii) Proceedings of meeting of any class of shareholders
(iii) Proceedings of meeting of any class of creditors
(iv) Proceedings of meeting of Board of Directors
(v) Proceedings of meeting of any committee of the Board; and
(vi) Every resolution passed by postal ballot

Manner of preparation and signing

(i) The minutes shall be prepared and signed in such manner as may be prescibed
(ii) All the appointments made at any meeting shall be included in the minutes
(iii) The minutes shall be maintained in the books kept for that purpose
(iv) The pages of the minutes book shall be consecutively numbered.

Time limits for preparation and signing

The minutes shall be prepared and signed within 30 days of –

(i) The conclusion of the meetings; or
(ii) Passing of the resolution by postal ballot

Contents w.r.t. board meetings

In case of a board meeting or of committee meeting, the minutes shall also contain –

(i) The names of the directors present; and
(ii) Where any resolution is passed at the meeting, the names of the directors, dissenting from the resolution and the names of the directors not concurring with the resolution.

Discretion of the Chairman

(i) No matter shall be included in the minutes, if the chairman is of the opinion that it is –

(a) Defamatory of any person; or

(b) Irrelevant or immaterial; or

(c) Detrimental to the interests of the company

(ii) The chairman shall exercise absolute discretion with regards to the inclusion or non-inclusion of any matter in the minutes on any of the grounds specified.

Minutes to be correct and fair

Minutes shall contain a fair and correct summary of the proceedings of the meeting.

Evidential Value

Minutes kept as per Sec 118 shall be evidence of the proceedings recoreded therein.

Presumption drawn from minutes

Where minutes are kept as per Sec 118, then, contrary is proved, it shall be presumed that –

(i) The meeting was duly called and held

(ii) All the proceedings at the meeting were duly taken place

(iii) All the resolutions passed by postal ballot were duly passed; and

(iv) In particular, all the appointments of directors, key manegerial personnel, auditors or company secretary in practice were validly made.

Publication of reports of proceedings

No document purporting to be a report of the proceedings of any general meeting of a company shall be circulated or advertised at the expense of the company, unless it includes the matters required by Sec 118 to be conatined in the minutes of the proceedings of such meeting.

Compliance with Secretarial Standards

Every company shall observe secretarial standards with respect to general meetings and Board meetings –

(i) Specified by the Institute of Company Secreatries of India

(ii) Approved as such by the Central Government

Punishment for contravention

If any default is made in complying with the provisions of this section, then –

(i) The company shall be liable to a penalty of ₹ 25,000; and

(ii) Every officer in default shall be liable to apenalty of ₹ 5,000

Punishment for tampering

Any person found guilty of tampering with the minutes shall be punishable with –

(i) Imprisonment upto 2 years; and

(ii) A fine of minimum ₹ 25,000 and a maximum of ₹ 1,00,000

(B) PROVIONS CONTAINED IN THE RULES

Distinct minutes book for each type of meeting

A distinct minute book shall be maintained for each type of meeting namely;

(i) General meeting of members (including the resolutions passed by postal ballot since such resolutions are deemed to be passed in general meeting)

(ii) Meetings of creditors

(iii) Meetings of the Board

(iv) Meetings of each of the comittes of the Board.

Manner of maintenance of minutes

(i) The minutes of proceedings of each meeting shall be entered in the books maintained for that purpose along with the date of such entry.

(ii) Every resolution passed by postal ballot shall be entered in the minutes book of general meetings.

(iii) With respect to every resolution passed by postal ballot, the minutes shall contain –

  (a) A brief report on the postal ballot conducted

  (b) The resolution proposed

  (c) The result voting

  (d) Summary of the scrutinizer's report

  (e) Date of entry in the minutes book

Manner of signing of minutes

Each page of every minutes book shall be initialled or signed, and the last page shall be dated and signed, as follows:

(i) Minutes of the Board meetings and comiittee meetings shall be signed by the Chairman of the same meeting or Chairman of the next meeting.

(ii) Minutes of General Meeting shall be signed by the Chairman of the same meeting within 30 days of conclusion of such meeting. In the event of the death or inability of that chairman within that period, by a director duly authorised by the Board for theis purpose.

(iii) Resolutions passed by postal ballot should be signed by the Chairman of the Board. If there is no chairman of the Board or in event of death or inability of the Chairman of the Board, by a director duly authorised by the Board for this purpose.

Presrvation of Minutes Book

The minutes books of general meetings, Board meetings and committee meetings shall be –

(i) Kept at the registered office of the company, or at such other place as may be approved by the Board;

(ii) Preserved permanently

(iii) Kept in the custody of the Company Secretary or any director duly authorised by the Board.

PRACTICAL EXAMPLES:

Question:

Board meetings were held on 24th July, 2015 and 14th August, 2015. Mr Raghav who was the chairman of these two Board meetings died on 20th August, 2015, without signing the minutes. How should the minutes be signed and by whom?

Answer:

As per section 118, the minutes of a Board meeting may be signed by the chairman of the said meeting or the chairman of the next succeeding meeting. The minutes shall be prepared and signed within 30 days of the conclusion of the Board meeting.

In the present case, the minutes of the meeting held on 24.07.2015 could be signed either by the chairman of the meeting held on 24.07.2015 or by the chairman of the next meeting held on 14.08.2015. Incidentally, the chairman of these two meetings is the same, i.e., Mr. Raghav, who has died. The result is that the minutes of the two previous Board meetings, held on 24.07.2015 and 14.08.2015, have remained unsigned. There is no legal provision covering the above situation. Therefore, it is advisable to convene a Board meeting and appoint a chairman who shall be authorised to sign the minutes of both the meetings held on 24.07.2015 and 14.08.2015.

Question:

Mr. Dixit, a member wants to inspect the minutes book of the meetings of the Board. Advise.

Answer:

Section 119 confers a right on the members of the company to inspect and obtain the copies of the minutes of a general meeting. However, this right does not extend to the minutes of a Board meeting.

The Companies Act, 2013 contains no provision either specifically permitting or prohibiting inspection by the shareholders of the minutes of the Board meeting. Unless the articles of the company otherwise provide, a shareholder has no right of inspection or of taking copies of the minutes of the Board meetings.

In the given case, if the articles of the company give a right to the members to inspect the minutes, the inspection cannot be declined; otherwise Mr. Dixit has no right to make the inspection.

PLACE, TIME AND DAY OF A BOARD MEETING

The provisions relating to place, time and day of a Board meeting are as follows:

Place of a Board meeting

Section 96 requires that an annual general meeting shall be held only at the registered office of the company or at any other place within the city, town or village in which the registered office of the company is situated. However, there is no similar provision in respect of holding of a Board meeting. As such, a Board meeting may be held anywhere in India or even outside India.

Day of a Board meeting

(a) Original Board meeting.

Section 96 requires that an annual general meeting shall be held only on a day which is not a national holiday. Since, there is no such provision in respect of a Board meeting, a Board meeting may be held even on a national holiday.

(b) Adjourned Board meeting.

As per section 174, if a Board meeting could not be held for want of quorum, then unless the articles otherwise provide, the meeting shall automatically stand adjourned to same day, time and place in the next week, or if that day is a national holiday, then to next succeeding day, which is not a national holiday. It means that unless the articles of the company otherwise provide, an adjourned Board meeting can be held only on a day which is not a national holiday.

Thus, it is evident that in the following two cases an adjourned Board meeting may be held on a national holiday:

(i) Where the Board voluntarily adjourns a duly convened Board meeting for a day which is a national holiday.

(ii) Where a Board meeting is adjourned for want of quorum, such Board meeting shall be held in accordance with the provisions contained in the articles. If the day prescribed in the articles happens to be a national holiday, the adjourned Board meeting can nevertheless be held on such national holiday.

Time of a Board meeting

Section 96 requires that an annual general meeting shall be held only during business hours. Since, there is no such provision in respect of a Board meeting, a Board meeting may be held even after business hours.

Unlike an annual general meeting, the time, place and day of a Board meeting have been left to the discretion of the directors.

PRACTICAL EXAMPLES:

Question:

Can the Board meeting be held in Delhi, when all the directors of the company reside at Mumbai?

Answer:

Section 96 requires that an annual general meeting shall be held only at the registered office of the company or at any other place within the city, town or village in which the registered office of the company is situated. However, there is no similar provision in respect of holding of a Board meeting. As such, a Board meeting can be held anywhere in India or even outside India.

Question:

Whether the Board meeting can be called on a national holiday and that too after business hours as the majority of the directors of the company have gone to Chennai on vacation.

Answer:

As per section 174, if *a* Board meeting could not be held for want of quorum, then, unless the articles otherwise provide, the meeting shall automatically stand adjourned to the same day, time and place in the next week, or if that day is a national holiday, then to next succeeding day, which is not a national holiday. It means that a Board meeting adjourned for want of quorum can be held only on a day which is not a national holiday. However, there is nothing in the Act which prohibits the holding of an original Board meeting on a national holiday. Similarly, the Act does not require that a Board meeting shall be held only during business hours.

In the instant case, the directors intend to hold a Board meeting on a national holiday and after business hours, which is permissible.

Question:

Is it necessary that the notice of the Board meeting should specify the nature of business to be transacted?

Answer:

No form or contents of notice has been specified by the Act. Agenda of a Board meeting is not required to be sent along with the notice of a Board meeting unless there is some express provision of the Act which requires a specific notice to move a resolution at a Board meeting.

Therefore, the notice of Board meeting need not specify the nature of business to be transacted.

CHAIRPERSON OF THE BOARD MEETING

Every meeting of the Board must be presided over by a Chairperson. The provisions relating to appointment of Chairperson, casting vote of Chairperson etc. are explained as follows:

Chairperson - The presiding officer of a meeting

The main function of a Chairperson is to preside over the meetings, and conduct them in an orderly manner. A Chairperson is always a part time Chairperson (even if he is the whole time director of the company) since he can occupy the chair only when the meeting is in continuation. His main duties are as follows:

(a) To preserve order at the meeting, and conduct deliberations in an orderly manner.

(b) To ensure that the meeting is duly convened and properly conducted, the business is transacted in accordance with the provisions of the Act and memorandum and articles of the company.

(c) To ensure that sense of the meeting is properly and accurately ascertained.

Appointment of a Chairperson

There is no statutory provision (except Regulation 70 of Table F) dealing with the appointment of the Chairperson.

Regulation 70 of Table F: The provisions contained in Regulation 70 of Table F are as follows:

(a) The Board may elect a Chairperson of its meetings and determine the period for which he is to hold office.

(b) If no such Chairperson is elected, or if at any meeting the Chairperson is not present within 5 minutes after the time appointed for holding the meeting, the directors present may choose one of themselves to be Chairperson of the meeting.

Appointment as per articles

The Chairperson is appointed in accordance with the provisions contained in the articles of the company. Regulation 70 of Table F contains the model provisions. A company is free to incorporate in its articles such provisions in a modified form.

Who can be the Chairperson?

(a) No proxies are allowed at a Board meeting. As such, only a director of the company can be appointed as a Chairperson.

(b) There is no requirement that only a whole time director shall be appointed as the Chairperson. Even a non-executive director may be elected as a Chairperson.

(c) A director need not be a shareholder and as such a non-shareholder director may also be appointed as a Chairperson at a Board meeting.

Casting vote of Chairperson

Casting vote means a second vote or deciding vote exercisable by the Chairperson of the Board. It helps in resolving a deadlock in the Board. In case of equality of votes, the resolution is lost, unless the position is resolved by the use of the casting vote of the Chairperson, if any.

(a) The Chairperson has a casting vote only if such a power is contained in the articles [Firestone Tyre and Rubber Co. v Synthetics and Chemicals Ltd. (1971) Comp Cas 377].

(b) As per Regulation 68 of Table F, the Chairperson of the Board may use his casting vote in case of equality of votes.

(c) The Chairperson of the Board has the discretion to use his casting vote, i.e. he may decide not to use it. He may use the casting vote if it is in the interest of the company.

Chairperson of the Board vis-a-vis Chairperson of the Board meeting

(a) When the Board elects a Chairperson for a certain period, the Chairperson so elected is called as the Chairperson of the Board.

(b) When the Chairperson of the Board is not elected, or he is not present, or he is not willing to act as a Chairperson, the directors present in the Board meeting may appoint a Chairperson for the conduct of the Board meeting. However, he remains a Chairperson for that particular Board meeting only and therefore he is called as Chairperson of the Board meeting.

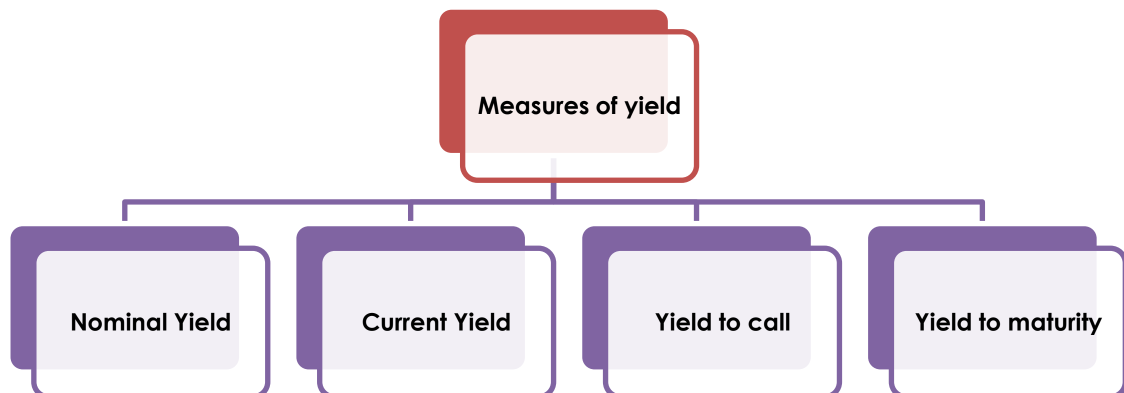
Casting vote

Regulation 68 of Table F gives a power to the Chairperson of the Board to exercise a casting vote. Accordingly, where a company adopts regulation 68 of Table F in its articles, only the Chairperson of the Board can use a casting vote. The Chairperson of the Board meeting shall not have a casting vote [Ramjilal Baisiwala v Baiton Cables Ltd. (1964) ILR 14 Raj 135].

BOND YIELDS

The yield of a bond is the return on the bond. The yield is expressed as an annual percentage of the face amount. However yield is a little more complicated than the coupon rate.

There are several different measures of yield.



Nominal Yield is equal to the coupon rate , that is , the return on the bond without accounting for any outside factors. If you purchase the bond at par value and hold to maturity , this will be the annual return you receive on the bond.

Current Yield is a measure of the return on the bond in relation to the current price. For example, depending on how interest rates have changed, you could purchase the bond a ₹100 par value bond for ₹80. If it pays 5% coupon annually (₹5), then the current yield is the return on your interest payments based on ₹80 investments, which would be 5/80=6.25%. So you see this differ from the coupon rate 5%.

Yield to call is the rate of return that an investor would earn if he bought a callable bond at its current market price and held it until the call date given that the bond was called on the call date.

Yield to maturity (YTM) is the rate of return that an investor would earn if he bought the bond at its current market price and held it until maturity, is called as its YTM. It represents the discount rate which equates the discounted value of a bond's future cash flows to its current maket price. This is the most valuable measure of yield because it reflects the total income that you can receive.

We know that bond price is nothing but the present value of all coupon streams plus the maturity amount that will be available at maturity.

$$P = c(1+r)^{-1} + c(1+r)^{-2} + ... + c(1+r)^{-n} + B(1+r)^{-n}$$

c= annual coupon payment (not a percent)

n= number of years to maturity

B= par value

P = purchase price

R which solves the equation is Yield to Maturity (YTM) of the bond. (similar to IRR method.)

Another apprroximate formula can be used to find YTM. It is given as

$$= \frac{\text{Income} + \text{Capital gains per annum}}{\text{Average Investment}} = \frac{C + \text{Pro-rated discount}}{(M+P)/2} = \frac{C + (M-P)/n}{(M+P)/2}$$

C = the annual coupon payment

M = maturity value of bond

P= the current price of the bond

Relationships between coupon rate, current yield and Yield to maturity should be as follows:

Nature of Bond	Relation
Par Bond	Coupon rate = Current Yield= YTM
Discount Bond	Coupon rate < Current Yield < YTM
Premium Bond	Coupon Rate > Current Yield>YTM.

EXAMPLE

1. **DHP Company has sold ₹1000, 12% debentures 10 years ago. Interest rates have risen since then, so that debentures of this company are now selling at 15% yield basis. Now the debentures of the company are selling at ₹825. Moreover, if the 12%, debentures have 8 years to run to maturity, compute the approximate effective yield an investor would earn on his investment.**

Current market price is ₹825 and is redeemable after 8 years.

Approximate YTM can be given by

$$= \frac{C + \text{Pro - rated discount}}{(M+P)/2} = \frac{C + (M - P)/n}{(M+P)/2} = \frac{120+(175/8)}{(1000+825)/2} = 15.5\%$$

Where C is the annual coupon payment, M is the maturity value of bond P is the current price of the bond.

Now we try to find the exact YTM using discount factor of 16%.

Year	Events	Cash flow	PV Factor 16%	PV of Cash flows
1-8	Interest	120	4.3436	521.230
8	Maturity	1000	0.3050	305.00
Total				826.23

Thus we find that for discount rate of 16%, the debenture value approximates to ₹825. Therefore 16% which is the effective yield the investor would look for on his investment.

2. **A 5 year bond with 8% coupon rate and maturity value of ₹1000 is currently selling at ₹925. Find what is the yield to maturity?**

Method I

YTM is that k_d which satisfies the equation,

$$925 = \frac{80}{(1+k_d)} + \frac{80}{(1+k_d)^2} + \frac{80}{(1+k_d)^3} + \frac{80}{(1+k_d)^4} + \frac{1080}{(1+k_d)^5}$$

Therefore let us try for 9%, 10% and 11%

PVIFA (9%, 5 years) × 80 +1000 × PVIF(9%,5 years) = ₹961.20

PVIFA (10%, 5 years) × 80 +1000 × PVIF(10%,5 years) = ₹924.28

PVIFA (11%, 5 years) × 80 +1000 × PVIF(11%,5 years) = ₹888.68

Since the present value of ₹925 matches almost perfectly with 10%, we can say that YTM is 10%. Else we interpolate with any two values to get the approximate answer of 10%

Method II

Approximate YTM can be given by

$$= \frac{C + \text{Pro-rated discount}}{(M+P)/2} = \frac{C + (M-P)/n}{(M+P)/2}$$

Where C is the annual coupon payment, M is the maturity value of bond, P is the current price of the bond

$$= \frac{80 + (75/5)}{(1000+925)/2} = \frac{95}{962.5} = 9.87\%$$

Therefore YTM = 9.87%

Note: Method I is preferable, as the answer is more accurate.

THANK YOU

PRICE INDIFFERENCE POINT

Pricing decisions are important for all types of organizations. The concept of price indifference point is important in short term decision making.

A price indifference point is the sales level at which the company's net income is identical between two pricing alternatives. The price indifference point indicates the volume of sales at which the new price generates a profit equal to the profit of the old sales volume and price. If management expects sales volume with the new price to be below the price indifference point, price increases should be rejected because company profit will decline. Conversely, the price change should be implemented, if the expected sales volume with the price increase is greater than the price indifference point, because profit will increase. Thus consideration of price indifference point is very relevant in deciding upon proposed increase in price.

example 1

Happy Singh & Co. manufactures stoves that it sells to dealers for ₹8.00 per unit. The company is contemplating an increase in selling price to ₹9.00 per unit. If selling price is increased, the volume of sales is expected to decline.

Company is willing to increase the price if resulting net income is sales (25,000 units @ ₹8)	₹2,00,000
Less: Variable cost (25,000 unit @ ₹5)	₹(1,25,000)
Fixed cost	₹(45,000)
Profit	₹30,000

How can the volume of sales decline before the price indifference point is reached? Check your answer by detailed calculation and comments on it.

Answer:

Determination of sales levels at which profit of ₹30,000 is earned with revised selling price.

We know that:

(Selling price per unit x Units sold) = (Variable cost x Units sold) + Fixed cost + Target profit

Suppose, y represents number of units sold, then

Or, ₹9y = ₹5y + ₹45,000 + ₹30,000

Or, ₹4y = ₹75,000

Or, y = 18,750 units

To check the answer, net income at 18,750 units with the new selling price is determined as follows:

Revenue 18,750 units x ₹9	₹1,68,750
Less: Variable cost 18,750 units x ₹5	₹(93,750)
Fixed cost	₹(45,000)
Profit	₹30,000

This means that, if new price is to be accepted, sales must be more than 18,750 units, which represents price indifference point. For example, if 21,000 units are expected at a selling price of ₹9, profit of Maan & Co. will be ₹39,000, i.e, ₹9,000 higher than the present profit at old price. The price indifference point is only one important consideration for management and it is not the only consideration. The decision may get affected by other factors such as firm's public image, employee's job security, competitors' action or management's strategy.

The effect of multiple changes on price indifference point:

A variety of factors may be included in the analysis. For example, Maan & Co. in the preceding example may plan to raise the price of stoves to ₹10, but will improve the reliability of stoves by using a better burner element. The company estimates that proposed changes will increase marketing and production fixed cost by ₹5,000 and variable cost by Re.1.00. The answer can be found out as follows:

(New price x No. of units) = (New variable cost x number of units) + old fixed cost + additional fixed cost + profit
Suppose y represents number of units.
New, substituting values and solving:
Or, ₹10y = ₹6y + ₹45,000 + ₹5,000 + ₹30,000
Or, y = 20,000 units

Therefore 20,000 units is the price indifference point. If expected sales at the new price are greater than 20,000 units, then the new price and associated costs should be implemented. It should be noted that comparison is between two pricing alternatives, the old price and the new price. Although, we add some cost changes, there are still only two alternatives being evaluated. The price indifference point does not establish a price, but it assists manager in evaluating two distinct pricing alternatives.

example 2

A company proposes to install a machine for the manufacture of a component which at present is being purchased at ₹24 each. There are two alternatives, namely (a) installation of an automatic machine and (b) installation of a semi-automatic machine. The details of the two machines are as under:

	Automatic Machine	**Semi-automatic Machine**
Initial cost of the machine (₹)	9,00,000	6,00,000
Life	10 years	10 years
Fixed overheads other than depreciation on machine (per annum (₹)	1,62,000	84,000
Variable expenses of the component (₹)	12	15

The company changes depreciation on straight line method. Scrap value of the machine at the end of life is nil. The demand for the components at present is 20,000 units per annum; This demand is expected to increase to 40,000 units.

Required

(a) For each of the two volumes of output namely 20,000 and 40,000 units, state with supporting calculations whether the components should be purchased or manufactured by installation of machine. If your decision is an favour of installation of machine, which model will you advice?

(b) At what volume of output should the company change over from purchase of components to manufacture by installation of (i) Semi-automatic machine and (ii) automatic machine.

(c) At what volume of manufacture of the components will the company switch over from installation of one type of machine to the other?

Answer:

(a) Statement showing the cost per unit under various alternatives.

	20,000 units		**40,000 units**	
	Automatic Machine	**Sem-automatic Machine**	**Automatic Machine**	**Semi-automatic Machine**
Variable cost	12.00	15.00	12.00	15.00
Fixed overheads other than depreciation	8.10	4.20	4.05	2.10
Depreciation	4.50	3.00	2.25	1.50
Total cost of manufacture	24.60	22.20	18.30	18.60
Cost of buying per unit	24.00	24.00	24.00	24.00

It is profitable to install semi-automatic machine at the production level of 20,000 units. However at the volume of 40,000 units, automatic machine should be installed.

(b) Change over from purchase to manufacture.

	Automatic Machine	**Semi-automatic Machine**
1. Purchase price of component	₹24,.00	₹24.00
2. Variable costs of manufacture	12.00	15.00
3. Saving	12.00	9.00
4. Total fixed costs as per footnote	₹2,52,000	₹1,44,000
5. Number of units at which change over is effected (4) ÷ (3)	21,000	16,000

(c) Switchover from one type of machine to the other

	Automatic Machine	Semi-automatic Machine	Difference
1. Variable cost	₹12	₹15	₹3
2. Total fixed cost	₹2,52,000	₹1,44,000	₹1,08,000
Number of units at which change over is effected (Differential cost ÷ S.No.1) = 36,000 units			

*F.O per unit	1,62,000 ÷ 20,000=8.10	84,000 ÷ 20,000=4.20	1,62,000 ÷ 40,000=4.05	84,000 ÷ 40,000=2.10
@Depreciation per unit	₹90,000 ÷ 20,000=4.50	60,000 ÷ 20,000=3.00	90,000 ÷ 40,000=2.25	60,000 + 4000=1.50
Total fixed cost	₹2,52,000	1,44,000	2,52,000	1,44,000

FREQUENTLY ASK QUESTIONS ON INCOME FROM OTHER SOURCES

(1). Please advise whether, in order to declare income from card games, any conditions are to be fulfilled, and whether the income must be proved to the satisfaction of the Assessing Officer and if so, how it must be proved?

No specific conditions are required to be fulfilled before declaring income from card games. A mere declaration of the income will do, and it is up to the Assessing Officer to probe further to find out the factual correctness of the receipt of income, if he feels so. The winner need not furnish proof to corroborate the winnings with the losses incurred by others. If the Assessing Officer desires to know the names of the other participants, the winner is bound to furnish the requisite information.

(2). Under section 2(22)(d) any distribution to its shareholders by a company on the reduction of its capital, to the extent to which the company possesses accumulated profits (which arose after the end of the previous year ending next before the 1st day of April, 1933) whether such accumulated profits have been capitalised or not is treated as deemed dividend. I want to know on which date deemed dividend would be calculated. Is it the date of passing of resolution which authorises the reduction of share capital or is it the date on which High Court sanctions the reduction ?

As per the Explanation 2 to section 2(22), the expression "accumulated" profits shall include all profits of the company upto the date of distribution or payment. Therefore, accumulated profits on the date of distribution will be taken into consideration.

(3). One of my clients is a closely held company. In the financial year 2013-14, the company has given a loan of ₹ 45,00,000 to one of its director who was holding 11.5 per cent share capital. During 2013-14, the company does not have any general reserve. However, there is share premium account of ₹ 50,00,000. The loan is re-paid by the director within 2 months but in the next financial year 2014-15. The Assessing Officer wants to treat share premium account as accumulated profit and wants to treat this loan as deemed dividend under section 2(22)(e). According to him it is taxable as dividend in the hands of the director under section 56(2) under the head "Income from other sources". At the same time the department wants to take action against the company for not deducting tax at source under section 194. I want your opinion whether the loan can be treated as deemed dividend under section 2(22)(e) when the company does not have accumulated profit. Is it possible to include share premium account in accumulated profit ? Is it possible to invoke section 194 for not deducting tax at source?

Section 52 of the Companies Act, 2013 deals with the application of premium received on issue of shares. It states that the premium received shall be transferred to a separate account styled 'the share premium account' and further states that the provisions relating to the reduction of the share capital of the company shall apply as if the share premium account was paid-up share capital of the company. Further, section 52 gives five purposes for which alone the share premium account may be applied without attracting the provisions of the 2013 Act relating to the reduction of the share capital. These are:

(a) to pay up fully paid bonus shares to be issued to the members;
(b) to write-off preliminary expenses of the company;
(c) to write-off expenses of issue of shares or debentures or underwriting commission paid or discount allowed on such issues;
(d) to pay premium on the redemption of redeemable preference shares or of any of debentures of the company; or
(e) to purchase of its own shares or other specified securities in terms of section 68,

barring the above five cases, any other application of the proceeds of the share premium account will be treated as a reduction of the company's share capital and the provisions of the 2013 Act dealing with this subject stand attracted. The share premium account cannot be used otherwise than for the specific purposes mentioned above. When there is a statutory bar on the share premium account being used for distribution of dividend, the deeming provisions of section 2(22)(e) cannot apply. Not only is there a prohibition on the distribution of the share premium account as dividend under the 2013 Act, the same is obliged to be treated as a part of the share capital of the company and this is made clear in section 52 of the 2013 Act which says that any payment out of the share premium account, except for purposes authorised by sub-section (2), will be treated as reduction of share capital attracting the provisions of the 2013 Act in relation thereto.

Consequently, in your case share premium account cannot be taken as part of accumulated profit. It appears from your query that there is no other accumulated profit with the company. In such a situation the deeming provision of section 2(22)(e) cannot be invoked. Nothing is, therefore, taxable in the hands of direct tax under section 56(2). Likewise, the application of section 194 is not possible.

(4). I am an employee of a company controlled by PVS Group. One of the items in our remuneration plan is gift of ₹ 30,000 from the employer company. CTC is calculated after including ₹ 30,000 in the case of each employee. During the financial year 2014-15, I can avail this perquisite. I have not received any other gift from any other person during the current year. I am not likely to get any other gift from any other person up to March 31, 2015. In other words, the total amount of gift for the financial year 2014-15 will be ₹ 30,000. According to my understanding, nothing to chargeable to tax under section 56(2)(vii), if the aggregate amount of gift received from one or more persons during a financial year is ₹50,000 or less than ₹ 50,000. Consequently, in my case nothing should be chargeable to tax. However, the Accounts Department's head of the company has a different version. He wants to deduct TDS under section 192. I am unable to understand as to how TDS provisions of section 192 is applicable in the case of income which is taxable (or which is tax-free) within the parameters of section 56(2)(vii). Does it may any difference if CTC is calculated without including the aforesaid ₹ 30,000.

Payment received from the employer by an employee is taxable in the hands of the employee under section 15 (read with section 17) under the head "Salaries". It cannot be taxed under the head "Income from other sources". To put it differently, it can be stated that if gift is received by an employee from his/her employer, it will be taxable only under the head "Salaries". If gift is received from a person other than employer, then one can invoke the provisions of section 56(2)(vii). In your case, section 56(2)(vii) is not applicable as gift is received from the employer. Section 56(2)(vii) is not applicable regardless of the fact whether ₹ 30,000 is part of CTC or CTC is calculated without including ₹ 30,000.

If gift is received in kind, ₹ 5,000 is not chargeable to tax and the value of perquisite under section 17(2)(viii) [read with rule 3(7)(iv)] will be ₹ 25,000. Conversely, however, if gift is received in cash or by cheque, the entire ₹ 30,000 will be taxable as profits in lieu of salary under section 17(3).

FREQUENTLY ASK QUESTIONS ON INCOME OF OTHER PERSONS INCLUDED IN ASSESSEE'S TOTAL INCOME

(1) A wants to create discretionary trust (as provided in section 164) for the benefit of sons and daughters of his brother B by settling a sum of ₹ 40 lakh. None of the beneficiaries is having income chargeable to tax (i.e., exceeding the maximum amount not chargeable to tax in case of an AOP) and none of them is beneficiary under any other trust. Advise—

(a) Whether income earned by the trust (not from business) will be clubbed in the hands of B as all the beneficiaries are his minor sons and daughters only although no specific share of income is attributable to any of them personally.

(b) If answer to above question is in affirmative, will it make any difference if a minor child of another relative C is also named as beneficiary.

(c) Whether there is any requirement that the beneficiaries in such type of trust should be dependent on the settler.

In CIT v. D. V. Narasimhan [1992] 196 ITR 490 (Kar.) since affirmed in CIT v. M.R. Doshi [1995] 211 ITR 1 (SC), the view taken is that through the medium of transfer to a trust for the benefit of a minor, with the rider that the same will be handed over to the minor on attaining majority, the provisions of section 64(1) may be circumvented. The provisions of the present section 64(1A) also may be circumvented as what is includable in the parent's income thereunder is the totality of the income accruing or arising to the minor. As, in case of availability of the benefit of the trusts' income being deferred till majority, no income would accrue or arise to the minor during his minority. Other cases to which reference may be made in this regard are CIT v. M.K. Doshi [1980] 122 ITR 499 (Guj.) and CIT v. T. Ponnaiah [1988] 172 ITR 269 (AP).

In view of the above, the proper course would be to constitute a trust on the lines indicated in the cases mentioned above. If that is done, recourse to alternative (2) in the query would not be necessary. Regarding (1), it would be better to indicate the shares of the beneficiaries in the trust. As regards query (3), the reply is in the negative.

(2). On November 2, 2013, A (minor child) gets a gift of ₹ 10 lakh from a person other than his relative. On the same day, the amount is deposited in a bank (interest income for the previous year ending March 31, 2015 is ₹ 12,900). Discuss whether the income would be taxable in the hands of A's father or mother under the provisions of section 64.

The clubbing provisions of section (1A) will be applicable. Consequently, the amount of income would be included in the income of A's father or mother whose income before this clubbing is higher, as follows—

	₹
Gift treated as income under section 56(2)	**10,00,000**
Bank interest	**12,900**
Total	**10,12,900**
Less: Exemption under section 10(32)	**1,500**
Income to be included in the income of A's father or mother	**10,05,400**

(3). A, having other income of ₹ 30,000 per annum is holding shares of ₹ 1 lakh and Mrs. A having no other income is also holding shares of ₹ 1 lakh in a private limited company having a paid-up share capital of ₹ 6 lakh. A is drawing a salary of ₹ 3,500 per month and Mrs. A is drawing a salary of ₹ 1,500 per month from the said company. What will be the position under section 64(1)(ii) read with Explanations / and 2 if (i) both A and Mrs. A are among the directors of the said company, or (ii) Mrs. A is a director of the said company and A is an employee with the same company as one of the professional personnel ?

A and Mrs. A are relatives within the meaning of section 2(41) and each of them (together with the other) holds a substantial interest in the company, being one-third of the total paid-up share capital. Explanation 2 to section 64(1)(ii) is clearly applicable to each of them. Aggregation of the salary of both in the hands of whichever has larger income, excluding the salary, is unavoidable, unless the salary can be attributed "to the application of his or her technical or professional knowledge and experience". Directorship has no relevance

to the issue. Technical or professional qualifications will be entitled to treatment of the income derived though their application as the personal income of the spouse concerned.

(4). A has a shop. He leased out the open area above the shop to his wife on rent of ₹ 100 per month. A's wife constructed with her own independent resources a shop on the first floor and let it out on rent of ₹ 2,000 per month. Kindly advise whether such a lease is permissible and whether there is any possibility of Mrs. A's income being clubbed with that of A.

There is nothing in law which precludes a person from letting out or leasing any part of his property to his wife for a consideration. If it can be established that the wife constructed the shop on the first floor with her own independent resources, there is no question of clubbing the income from such property with that of her husband.

There does not appear to be any case law on the specific point raised. However, in case the Assessing Officer questions the adequacy of the lease rent, the case has to be defended on facts. The cases of V. Amirtham Ammal v. CIT[1976] 102 ITR 350 (Mad.) and Mammon K. Cherian v. CIT[1976] 102 ITR 553 (Ker.) may be referred to. If the Assessing Officer attempts to invoke the decision of the Supreme Court in the case of CIT v. McDowell & Co. Ltd.[1985] 156 ITR 162, the case may be contested by distinguishing the facts and claiming that there is no attempt at avoidance of tax by the assessee.

(5). X gifted ₹ 50,000 to his wife in 1990. She purchased a plot and constructed a house with that amount. The rental income was assessed in the hands of X. If the house is now sold, will the capital gains be assessed in the hands of X?

In order to attract the clubbing provisions, the connection between the transfer of assets and the income must be proximate. In the case of CIT v. Pelleti Sridevamma[1976] 105 ITR 887 (AP), the assessee made a cash gift to her minor son, and with that amount, the son purchased a house. The income from the house property was rightly assessed in the hands of the assessee, in view of the proximate connection between the gift and the income. The house was sold by the son after about 8 years. On the question whether the resultant capital gains were also assessable in the hands of the assessee, the High Court held that, in view of the time-lag involved, there was no proximate connection between the capital gains and the original cash gift and the capital gains would not be assessable in the hands of the assessee. The facts, stated by X were almost similar to the facts in the aforesaid case, and hence, X would successfully claim, on the strength of the aforesaid decision that the capital gains arising on the sale of house property were not assessable in his hands.

DUTY DRAWBACK: AN IMPORTANT ASPECT OF CUSTOMS LAW

Drawback is an incentive given to exporters. This incentive operates repayment of duty paid in relation to exports. Drawback is allowed in two cases: (a) Drawback allowable on re-export of duty-paid goods (Section 74 of Customs Act) and (b) Drawback on imported materials used in the manufacture of goods which are exported (Section 75 of Customs Act).

(a) Drawback allowable on re-export of duty-paid goods (Section 74 of Customs Act): Only imported goods on which duty has been paid on importation are eligible for drawback. Such goods are identified to the satisfaction of the Assistant or Deputy Commissioner as the goods which were imported.

Extent of drawback: (i) 98% of duty paid on importation shall be repaid as drawback.
(ii) Where imported goods have been used, the Central Government will fix the rate of drawback having regard to — (A) duration of use, (B) depreciation in value and (C) other relevant circumstances.

Drawback rates-goods taken into use- after importation:

Length of period between the date of clearance for home consumption and the date when the goods are placed under Customs control for export	Percentage of import duty to be paid as Drawback
1. Not more than three months	95%
2. More than three months but not more than six months	85%
3. More than six months but not more than nine months	75%
4. More than nine months but not more than twelve months	70%
5. More than twelve months but not more than fifteen months	65%
6. More than fifteen months but not more than eighteen months	60%
7. More than eighteen months	Nil

Goods in respect of which no duty drawback is allowed: The following goods are not eligible for drawback if they are used after import:

1. Wearing apparel;
2. Tea-chests;
3. Exposed cinematographic films passed by the Board of Film Censors of India;
4. Unexposed photographic films
5. Paper and plates and x-ray films.

(b) Drawback on imported materials used in the manufacture of goods which are exported (Section 75 of Customs Act): Drawback u/s 75 is covered by the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995.

Restrictions on drawback: No drawback u/s 75 permissible if —

General	Notified Goods
Export value is < Value of imported materials used in manufacture / processing / operations. Example: import value = ₹ 10,000, drawback is eligible only if export value ≥ ₹ 10,000.	Export value is ≥ prescribed percentage of value of imported materials used in manufacture / processing / operations. Example: import value = ₹ 10,000 and prescribed percentage is 15%, drawback is eligible only if export value > ₹ 11,500.

Example: AB Ltd. sent certain goods by a ship from Kolkata to Colombo under claim for drawback on the said goods u/s 75 of the Customs Act, 1962 against shipping bill. The ship had passed beyond the territorial waters of India and the engine developed trouble while the ship was in high seas falling within the ambit of the expression 'taking out to a place outside India'. The ship returned back and ran around in Indian territorial waters at port of Paradeep. The fittings, stores and Cargo were salvaged. In this case, the assessee is entitled to claim drawback u/s 75 because when the ship got clearance and moved out of the territorial waters, 'export' was complete. The fact that the ship was brought back to India because of the damages in the ship does not affect the position. The case is similar to the case — **Sun Industries 35 ELT 241 (SC).**

Types of rates of drawback: Drawback u/s 75 can be granted on the basis of the following:

Type	Rate Determined by —
All Industry Rate (AIR) [Rule 3]	Central Government
Brand Rate [Rule 6]	Jurisdictional Commissioner of Central Excise / Customs, when AIR is not available
Special Brand Rate [Rule 7]	Jurisdictional Commissioner of Central Excise / Customs, when AIR determined is low, i.e. < 80% of input duties & taxes

Upper Limit of Drawback money or rate: The drawback amount or rate determined under rule 3 shall not exceed one third of the market price of the export product. [Rule 8A of the Customs, Central Excise Duties and Service Tax Drawback Rules, 1995].

- **All Industry Rate:** The drawback rate may be specified in terms of —
  - Rupee terms, i.e. amount will be mentioned;

- Percentage terms, i.e. drawback rate will be mentioned.

Factors Considered by Central Government: The following factors will be considered by the Central Government:

- Inputs for goods manufactured in India;
- Duties & taxes paid on inputs;
- Duties & taxes paid on packing materials used for export goods;
- Service tax paid on input services for manufacture, processing, packing etc.
- Other informations as deemed fit by Central Government.

- **Brand Rate [Rule 6]:** Manufacturer or exporter of the goods shall make an application in writing to the Jurisdictional Commissioner of Central Excise / Customs (as the case may be), for determination of amount / rate of duty.

  Contents of Application: The application shall state all the relevant facts including —

  - proportion in which the materials, components, or input services are used in the production or manufacture of goods, and
  - Duty / tax paid on such materials, components, or input services.

- **Special Brand Rate [Rule 7]:** Manufacturer or exporter of the goods shall make an application in writing to the Jurisdictional Commissioner of Central Excise / Customs (as the case may be), for determination of amount / rate of duty.

  Contents of Application: The application shall state all the relevant facts including —

  - proportion in which the materials, components, or input services are used in the production or manufacture of goods, and
  - Duty / tax paid on such materials, components, or input services.

The only difference between Brand Rate and Special Brand Rate is the situation. Brand Rate arises when AIR is not available but Special Brand Rate arises when AIR determined is low, i.e. < 80% of input duties & taxes.

CUSTOMER RELATIONSHIP MANAGEMENT

It is a strategic process that will help you better understand your customers' needs and how you can meet those needs and enhance your bottom line at the same time. Good customer relationships are the heart of business success. This strategy depends on bringing together lots of pieces of information about customers and market trends so you can sell and market your products and services more effectively.

So we can say, CRM is a cross-functional strategic approach concerned with creating improved Shareholder value through the development of appropriate relationships with key customers and customer segments.

Now the question is *"how does it happen?"*

It doesn't happen by simply buying software and installing it. For CRM to be truly effective, an organization must first understand who its customers are and what their value is over a lifetime. The company must then determine what the needs of its customers are and how best to meet those needs. For example, many financial institutions keep track of customers' life stages in order to market appropriate banking products like mortgages or IRAs to them at the right time to fit their needs. Next the organization must look into all of the different ways information about customers comes into a business, where and how this data is stored and how it is currently used. One company, for instance, may interact with customers of different ways including mail campaigns, Web sites, call centers, mobile sales force staff and marketing and advertising efforts. CRM systems link up each of these points.

Next the question is, "Are there any indications of the need for a CRM project?"

You need CRM when it is clear you don't have an accurate view of who your customers and what their needs or desires are or will be at any given stage in their lives. If you are losing customers to a competitor, that's a clear indication that you should improve your understanding of your customers.

Illustrate an example of Samsung – from low cost producer to product leadership by using CRM:

As today's emerging giants face the challenge of moving beyond their home markets, they have much to learn from the path breaking experience of South Korea's Samsung Group, arguably the most successful globalizer of the previous generation.

Samsung Group, the Korean multinational conglomerate, illustrates how dedication to a carefully designed business strategy can deliver spectacular results. The strategy development process in CRM consists of two components, the business strategy and the customer strategy. This case study focuses on the business strategy and examines how Samsung moved from a focus on low-cost product leadership to a winning strategy of delivering high-value products to appreciative global customers.

Founded in 1938, the Samsung Group is the largest corporate entity in South Korea. Best known for its flagship, Samsung Electronics (SEC)—producer of semiconductors, cell phones, TVs, and LCD panels—the group's highly diversified businesses span a wide range of industries, including financial services, information technology services, machinery, Shipbuilding and chemicals.

The challenge

By 1987, when Lee Kun-Hee succeeded his father as only the second chairman in the company's history, Samsung was the leader in Korea in most of its markets. But its overseas position as a low-cost producer was becoming untenable in the face of intensifying competition from Japanese electronics makers, which were setting up manufacturing plants in Southeast Asia, and rising domestic wages in South Korea's newly liberalizing economy.

In the early 1990s, Lee spotted an opportunity in the reluctance of Japanese companies the analog market leaders to adopt digital technology, which consumers were flocking to in cameras, audio equipment, and other electronic products. This opened the door for Samsung to surpass its rivals if it developed the agility, innovativeness, and creativity to succeed in the new digital market.

The solution

The opportunity to move into digital technology was a huge risk for Samsung. The investment in innovation cost the company over $2.45 billion annually, but resulted in a steady flow of new digital products which flooded onto the premium product market.

Into an organization focused on continuous process improvement, Samsung introduced a focus on innovation. Into a homogeneous workforce, Samsung introduced "new management initiative" which redesigning the company's culture. Samsung introduced merit pay and promotion, putting some young people in positions of authority over their elders. It has been a path marked by both disorienting disequilibrium and intense exhilaration.

Samsung invested heavily in sports sponsorship and this strategy has made a huge impact on customer awareness of the brand. From1997 Samsung secured worldwide Olympic sponsorship in the wireless equipment category and made remarkable success with this initiative. The company was a partner in the London 2012 Olympics. Sponsorship of these events has led to significant improvement in brand perceptions in global markets.

The results

Samsung's vision for 2020 is simple: 'Inspire the World, Create the Future'. To achieve this vision, the company looks to three key strengths: new technology, innovative products and creative solutions. The company recognizes that engaging more closely with customers and their changing needs will provide new value throughout its network and with three key stakeholders - customers, partners and employees.

Product quality is a priority, as Samsung knows that building consumer loyalty depends on it. Products are tested in a reliability lab and new products are developed incorporating customer insights on ease of use and reliability in real-life situations. Excellence in customer service and after-sales care is also central to Samsung's strategy. The company excels in customer care and has processes that provide swift action to respond to and rectify product defects and repairs. The Samsung brand is now synonymous with value, quality and reliability.

FORWARD EXCHANGE CONTRACT (ACCOUNTING STANDARD – 11)

What is forward exchange contract?

It is an agreement between two parties whereby one party agrees to buy from or sell to the other party an asset at future date for an agreed price; in case of forward exchange contract the asset is "foreign currency".

Example:

Mr. Mitra of Kolkata (India) want to import a plant worth US $ 100000 from USA, payment shall be made after three months of the import i.e. 1-6-2015.
The Exchange rate on this date is ₹ 65 per US $, which he expects to rise on the day of payment i.e. 31-8-2015. So he entered into forward buy contracts for ₹ 65.25 per US $ to cover any risk due to fluctuation of exchange rate now Mr. Mitra has ensured that he will get one dollar for ₹65.25 whatever may be actual exchange rate on the date of settlement i.e. 31-8-2015.

For the purpose of the accounting treatment forward exchange contract as been classified in two types:
- Forward exchange contract for managing risk (hedging).
- Forward exchange contract for trading or speculation.

Forward exchange contract for managing risk - The forward exchange contract which is entered into with an intention of minimizing the risk due to fluctuation in exchange on the date of the settlement of the transaction is the contract for managing the risk.

The premium or discount that arises on entering into the contract is the difference between the exchange rate at the date of the inception of the forward exchange contract and forward rate specified in the contract.

Taking the same example —

the exchange rate on the date of settlement i.e. 31-8-2015 is ₹ 67.40 per US $.
The exchange rate on 1-6-2015 - ₹ 65.00 per US $,
Forward rate booked - ₹ 65.25 per US $

In this situation:

Forward premium = (65.25 - 65.00) × US$ 1,00,000 = ₹ 25,000.

As per the accounting standard this should be expensed over the tenor of contract i.e. three months (1-6-2015 to 31-8-2015).

Exchange difference - (67.40 - 65.00) × US $ 1,00,000 = ₹ 2,40,000 (gain) should be recognized by crediting it to the profit and loss statement.

If forward exchange contract is cancelled the profit or loss arising on cancellation is recognized in profit and loss statement for the period.

Forward exchange contract for trading or speculation –

When the forward exchange contract is entered in to for earning profit by trading or speculation in foreign exchange, the accounting treatment shall be different (as the object is not to reduce the risk but to gain).

As per the accounting standard premium or discount on such forward contract not to be recognized and to be ignored.

At each balance sheet date the value of contract is marked so its current market value, gains or loss on the contract is recognized.

Example:

A dealer has bought three months forward contract for US $ 1,00,000 at ₹ 67.10 per US $ on 1-6-2015.
He closes his account on 30th June every year.
Exchange rate on 1-6-2015 was ₹ 67.02 per US $ and
On 30-6-2015 it was ₹67.15 per US $.
Two months forward contract was selling on 30-6-2015 at ₹ 67.18 per US $.

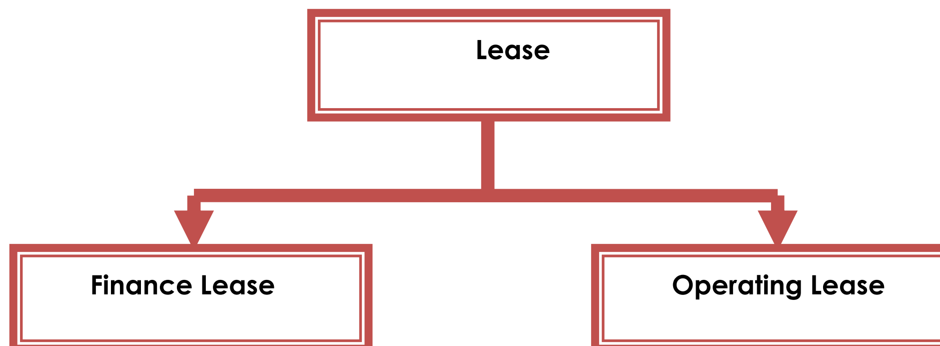
Answer:

This forward contract is entered into for speculative/trading purpose.

The dealer shall mark to market the forward contract on reporting date i.e. 30-6-2015 (67.18- 67.10) × 1,00,000= 8000 and should book the profit for ₹ 8,000 on 30-6-2015.

Suppose on 15.07.2015 the dealer sells the forward for ₹ 67.11 per US $ so on setting off the deal, he should book the loss of (67.18 - 67.11) × 1,00,000 = ₹ 7,000.

CLASSIFICATION OF LEASE (ACCOUNTING STANDARD – 19)



Finance Lease
It transfers substantially all the risks and rewards incidental to the ownership of an asset to leasee by the lessor but not the legal ownership.
The leasee will get the ownership of leased asset at the end of the lease terms
The lessee has an option to buy the leased asset at the end of term at price, lower than its expected fair value at the date on which option will be exercised.
The lease term covers the major part of the life of asset.
At the beginning of lease term, present value of minimum lease rental covers substantially the initial fair value of the leased asset.
The asset given on lease to lessee is of specialized nature and can be used by the lessee without major modification.

Operating Lease
It does not transfer substantially all the risks and rewards incidental to the ownership of an asset.

How to determine whether a lease agreement is a Finance Lease or Operating Lease

Example:

An equipment is leased for 3 years and its useful life is 5 years. Both the cost and the fair market value of the equipment are ₹6,00,000. The amount will be paid in 3 installments and at the termination of lease lessor will get back the equipment. The unguaranteed residual value at the end of 3 years is ₹80,000. The internal Rate of Return of the investment is 10%. The present value of annuity factor of ₹1 due at the end of 3rd year at 10% IRR is 2.4868. The present value of ₹1 due at the end of 3rd year at 10% rate of interest is 0.7513.
State with reason whether the lease constitute finance lease.

Answer:

IRR is 10%

Investment in lease is ₹6,00,000

If IRR is 10% that means Present Value of minimum lease payment (MLP) from lessor point of view plus unguaranteed residual value is equal to ₹6,00,000.

P.V. of unguaranteed residual value (80,000 × 0.7513) = ₹60,104

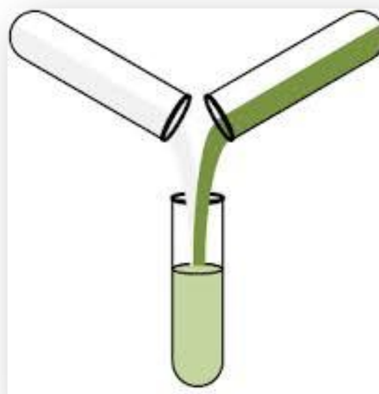
P.V. of Minimum lease Payment should be (6,00,000 – 60,104) = ₹5,39,896.

As at the beginning of lease period the P.V. of M>L>P cover substantially the initial fair value i.e. ₹5,39,896/₹6,00,000 = 89.98 % approx.

That means lease period covers major part of the lease of the asset.

Hence, it is a finance lease.

DILUTED EARNINGS PER SHARE (ACCOUNTING STANDARD -20)



When to calculate Diluted Earning Per Share?

Diluted earning per share is calculated when there are potential equity shares in capital structure of an enterprise. Potential equity shares are those financial instruments which entitle to its holder the right to acquire equity shares like convertible debentures, convertible preference shares, options, warrants etc.

How to compute Diluted Earning Per Share?

Net profit attributable to equity shareholders (after adjustment for diluted earnings) **divided by** Average number of weighted equity shares outstanding during the period (assuming the conversion of diluted potential equity.

Diluted potential equity shares - Potential equity shares are diluted **if their conversion into equity shares reduces the earning per share**.
If their conversion does not decrease the EPS, rather it increases the EPS, then the potential equity shares are not to be considered dilutive.

Steps of computing Diluted Earning

- Compute net profit or loss for the period attributable to existing equity shareholder.
- Add back dividend along with distribution tax on convertible preference shares previously deducted.
- Add back interest net of tax effect charged on convertible debenture or loans.

Potential equity share should be ranked in order of dilutive effect. Dilutive effect is determined dividing incremental net profit by incremental equity share arising out of conversion.

Example:

M Ltd. has equity capital of ₹40,00,000 consisting of fully paid equity shares of ₹10 each. The net profit for the year 2013-14 was ₹60,00,000.It has also issued 36,000, 10% convertible debentures of ₹50 each. Each debenture is convertible into five equity shares. The tax rate applicable is 30%. Compute the diluted earnings

Answer:

Computation of Diluted Earning:

Interest on Debentures @ 10% for the year	$36,000 \times ₹50 \times \frac{10}{100}$
	=₹1,80,000
Tax on interest @ 30%	= ₹54,000
Diluted Earnings (adjusted net profit)	= (₹60,00,000 + ₹1,80,000 - ₹54,000)
	= ₹61,26,000

and, in this case diluted earning per share is ₹61,26,000 / (4,00,000 + 1,80,000 i.e. 36,000× 5) = ₹10.56.