Due Diligence Reviews-

An Indirect tax perspective

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Introduction

What is Due diligence?

- Due Diligence (hereinafter also referred to as 'DD') is careful and methodological investigation of a business, to ensure that the information provided is accurate and to uncover such information that may affect the decisions/outcome of a transaction.
- In simple terms it is a through checking and analysis of a business

When is a DD generally conducted?

- Making a financial or strategic investment in the target company
- Merging with or acquiring the target company
- Raising funds

What are its objectives?

Based on the diligence report investigator may decide the following:

- Decide to withdraw from the deal
- Adjust the value of the investment
- Solve any apparent problem that may have been identified

Types of Due Diligence

Some of the most common types of DD's are:

Business DD

- Business DD aims to assess quality of investments, business prospects and parties to the transaction
- Such due diligence includes operational, strategic, HR, Information Security etc.

Legal DD

- Legal DD covers the legal aspects of a business transaction, potential liabilities, inter and intra corporate transactions etc.

Financial DD

- Financial DD includes review of accounting policies, internal controls, quality and sustainability of cash flows, condition of assets, potential tax implications on the business, potential tax implications on the transaction etc.

Types of Due Diligence

Financial DD (contd..)

- Tax DD generally forms part of the Financial DD to analyse the following:
  - tax compliances
  - tax contingencies and aggressive tax positions
  - identification of risk areas
  - tax planning and opportunities

- Further it would be relevant to note that generally a due diligence is conducted by and investor who wish to invest or acquire a target company.
- However at times a company in need of funds or desiring to sell its stake also conducts a DD on its business, such a due diligence in also referred to as vendor due diligence.
- Such a vendor due diligence report is helpful to attract investors.

Approach for conducting a DD

- Understand the scope of work
- Preliminary discussion with the investor to understand focus area
- Data collation and follow-up
- Data Analysis and Research
- Drafting the report and finalization

Indirect tax DD- Key points for consideration

- Indirect tax DD would generally involve analysis of Service tax, VAT, Excise, Entry tax, Entertainment tax, Customs, Foreign Trade policy and other law's as may be applicable depending on the business operations

Key steps to be followed are :

- Step 1: Imperative to understand the business to determine the applicability of various Indirect taxes

- Step 2: Map the whole business operations and corresponding applicable taxes.

- Step 3: Read/understand the agreements, the tax positions adopted and compliance followed by the company

Indirect tax DD- Key points for consideration

- Step 4: Discuss the reason for variances in tax positions determined and that adopted by company

- Step 5 : Discuss the key points and finalise the same at time of reporting.

Some common Indirect tax issues

Some common indirect tax issues that are generally observed during DD are:

- Potential Liability on account of non availability/pending declaration forms like Form C, Form F issued under Central Sales tax
- Potential Liability on account of non payment of VAT/CST on sale of scrap, predetermined interstate sales
- Potential liability on account of non fulfillment of export obligations under Foreign trade policy
- Non payment of service tax under reverse charge mechanism
- Valuation of goods under Excise/VAT
- Open assessments and pending litigations

Thank You