ACCOUNTING, REGULATORY & TAX NEWSLETTER

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ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA ("ICAI")

EAC Opinion – Classification of 'stock of track' as inventory or property, plant and equipment

Facts of the case

A Corporation (hereinafter referred to as 'the Corporation' or 'the Company') is a non-listed company incorporated in India with 50:50 equity participation of the Government of India (GOI) and the State Government. The Company was formed as a special purpose vehicle (SPV) to execute Mass Rapid Transit System (MRTS) in city 'L'. The Company has successfully implemented Phase 1A –North-South Corridor of the city 'L' Metro Project and commenced commercial operations. The Government further mandated it to implement the upcoming projects in other cities of the State. Henceforth, the constitution and name of the company were changed to ABC Metro Rail Corporation Limited. Presently, the Company, apart from running metro rail services in the city 'L', has commenced construction activity of metro projects in city 'K' and city 'A'.

During the construction of the city 'L' Metro Project, the Company had entered into various contracts for the procurement of tracks having a contract's value of INR 131.69cr and a contract with M/s XYZ for laying of tracks having a contract value of INR 121.82cr. The materials procured include sleepers, rails, clamps, etc. Out of the total stock of these materials, a material having a total value of INR 12.83cr was lying in the city 'L' metro project and shown under the 'Capital Work in Progress - Track Work' in Note No. 2 of the balance sheet for the financial year (F.Y.) 2020-2021, which is to be used in city 'K' and city 'A' metro rail projects, since track work of city 'L' was fully completed and there was no requirement of these materials for any future use at city 'L'.

Accounting treatment adopted by the Company:

The Company has further stated that it has procured the material and parked the expenditure incurred under the head 'Capital Work in Progress'. After the start of operation of the city 'L' metro on 8 March 2019, the Company has capitalised on the expenditure incurred on laying down the track under the head Property, Plant and Equipment- Track work (Note No. 1 of the Balance sheet for the F.Y. 2020-2021). Out of the total stock, the stock has a total value of INR 12.83cr was lying in city 'L' metro project and shown under the 'Capital Work in Progress-Track Work' in Note No. 2 of the balance sheet for F.Y. 2020- 2021 with the intent to use track materials including rails in other metro projects at city 'K' which was scheduled to be made operational in the month-end of December 2021. It may be pertinent to mention that the track is a 'fixed asset' item but capitalised on the commercial commencement of the corridor.

Therefore, as a prudent practice, the track rails materials valuing INR 12.53cr was shown under 'Capital Work in Progress' and since city 'K' Metro is going to start from the month-end of December 2021, the same will be capitalised under the head 'Track Work' in Property, Plant and Equipment (PPE).

Comment issued by Comptroller and Auditor General of India (C&AG):

During the supplementary audit of financial statements for the F.Y. 2020-2021, C&AG was of the view that surplus material lying under the head capital work in progress is to be treated as inventory within the ambit of Indian Accounting Standard (Ind AS) 2, 'Inventories'. The comment raised by the C&AG is reproduced below:

"Capital Work in Progress, city L (Note-2)

Track Work (P-Way) INR 12.83cr

The above represents surplus stores (Sleepers, Rails, clamps, etc.) at city 'L' Metro Project. These items are leftover items used for lying of new rail tracks and are not required at the city 'L' Project as the project is already completed and commissioned.

This resulted into the overstatement of 'Capital Work in Progress (city 'L')' and understatement of 'Inventory' by Rs. 12.83cr each."

Reply of the Company given to C&AG:

The Company was formed as a special purpose vehicle (SPV) on 25 November 2013 to execute Mass Rapid Transit System (MRTS) in city 'L' by providing metro rail. The Corporation successfully implemented Phase 1A – North-South Corridor (23 Km) within strict timelines and commenced commercial operations on 8 March 2019. The Government further mandated it to implement the upcoming projects in other cities of the State. Presently, the Company, apart from running metro rail services in the city 'L', has commenced construction activity in city 'K' (32.385 Kms) and city 'A' (30.45 Kms).

As per Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment', "Property, plant and equipment are tangible items that:

- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes
- are expected to be used during more than one period

Moreover, as per the definition of 'inventories' as given under Ind AS 2, 'Inventories';

Inventories are assets:

- held for sale in the ordinary course of business
- in the process of production for such sale
- in the form of materials or supplies to be consumed in the production process or in the rendering of services

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From the above, it can be noted that the classification of an asset as a 'property, plant and equipment' or 'inventories' depends on its intended primary use for an entity. If an asset is essentially held for using it to produce or provide goods or services rather than for sale in the normal course of business, it is classified as 'property, plant and equipment'.

Auditors should appreciate the fact that tracks held by the Company are clearly falling under the definition of 'Property, Plant and Equipment' as stated above and not under the definition of 'Inventories' as per Ind AS 2. As a measure to reduce the cost of city 'K' and city 'A' metro projects, management has taken a conscious decision to use these materials during the construction of city 'K' and city 'A' metro projects. A part of said materials has already been transferred to the city 'K' metro project and the same will be capitalised as assets once the tracks will be put to use for the city 'K' metro Project.

Based on the above facts, it is clear that the above material does not fall in the ambit of inventories as defined in Ind AS 2 and the same is correctly classified by the Company under 'Work in Progress' hence no corrective action is envisaged on this matter.

Matter of Dispute:

As per C&AG, stock of track-related items should be classified as inventory. As per the Company, this stock does not fall under the definition of inventories as per Ind AS 2 and the same is held for laying tracks which will form part of PPE only. The Company has already transferred some portion of this material to city 'K' metro rail projects for laying rail track which will be capitalised under the head 'Property, Plant and Equipment' as per Ind AS 16 after commencement of city 'K' metro rail project.

Query

On the basis of the above, the Company has sought the opinion of the Expert Advisory Committee (EAC) regarding the accounting treatment of stock of track work in view of C&AG observation. Also, whether the treatment adopted by the Company is correct or not.

Points considered by the Committee

The Committee notes that the basic issue raised in the query relates to the accounting treatment of stock of tracks held by the Company, which is surplus material for one of the metro projects but is being held for consumption in other projects. The Committee has, therefore, considered only this issue and has not examined any other issue.

In order to determine the classification of the asset (stock of track), the Committee notes the definition of the term 'inventories' as given in Ind AS 2:

Inventories are assets:

- held for sale in the ordinary course of business
- in the process of production for such sale
- in the form of materials or supplies to be consumed in the production process or in the rendering of services

From the above, the Committee notes that the classification of an item as 'inventory' depends on its intended primary use for an entity.

In the extant case, the 'stock of track' is neither held for sale in the ordinary course of business; nor it is in the process of production for such sale, nor in the form of materials or supplies to be consumed in the production process or in the rendering of services. Therefore, the same does not meet the definition of 'inventories'.

The Committee now examines the following requirements of Ind AS 16:

Property, plant and equipment are tangible items that:

- are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes
- are expected to be used during more than one period

7 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- future economic benefits associated with the item will probably flow to the entity
- the cost of the item can be measured reliably

From the above, the Committee notes that in the extant case, stock of tracks is tangible items, which upon laying/installation as metro tracks will be used for providing services and will be used during more than one period. Therefore, tracks once laid/installed will meet the definition of PPE. s

The Committee further notes that the 'Glossary of Terms used in Financial Statements', issued by the Research Committee of the Institute of Chartered Accountants of India defines the term, 'capital work in progress' as follows:

31. Capital Work-in-progress

Expenditure on capital assets that are in the process of construction or completion.

The Committee notes from the Facts of the Case that the stock of tracks is surplus for the time being at the site of one project and is awaiting its use in other projects. However, this does not change the basic nature of the materials acquired for the construction/creation of an item of PPE and therefore, is expenditure on capital assets that are in the process of construction or completion. Accordingly, the same should be classified under 'capital work in progress'. The Committee is further of the view that since the metro project of city 'L' is fully completed and has commenced commercial operations, the stock of tracks should not be termed as capital work in progress (CWIP) of a metro project of city 'L'; rather these should be classified under CWIP of metro projects of city 'K' and city 'A' to the extent these will be used for these metro projects.

Opinion

On the basis of the above, the Committee is of the opinion that the 'stock of track' should not be termed as capital work in progress (CWIP) of the metro project of city 'L'; rather should be classified under capital work in progress of metro projects of city 'K' and city 'A' to the extent these will be used for these metro projects.

REGULATORY UPDATES

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) (Third Amendment) Regulations, 2022

The SEBI vide notification dated 25 July 25 2022 has brought amendments to the Securities and Exchange Board of India (Issue of Capital and Disclosure Requirements) Regulations, 2018 by insertion of a new chapter, Chapter X-A - "Social Stock Exchange" (SSE).

SEBI has notified a framework for the SSE for providing social enterprises (SEs) an additional avenue to raise funds. SEs include registered charitable trusts, societies and a company incorporated under Section 8 of the Companies Act, 2013.

This notification further defines Social Stock Exchange as a separate segment of a recognized stock exchange having nationwide trading terminals permitted to register Not for Profit Organizations and/ or list the securities issued by Not-for-Profit Organizations in accordance with provisions of these regulations.

Further SEs will have to engage in a social activity out of the list of 15 broad eligible social activities approved by the SEBI. Eligible non-profit organisations (NPOs) may raise funds through equity, zero coupons zero principal (ZCZP) bonds, mutual funds, social impact funds and development impact bonds.

Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) (Fifth Amendment) Regulations, 2022

The SEBI vide notification dated 25 July 2022 has brought an amendment to the Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 **by insertion of a new chapter, Chapter IX-A - Obligations of Social Enterprises.**

The provisions of this new Chapter shall apply to a For-Profit Social Enterprise whose designated securities are listed on the applicable segment of the Stock Exchange(s) and a Not-for-Profit Organization that is registered on the Social Stock Exchange.

These regulations, among others, prescribe that a Profit Social Enterprise whose designated securities are listed on the Stock Exchange has to comply with the disclosure requirements contained in these regulations with respect to issuers whose specified securities are listed on the Main Board or the SME Exchange or the Innovators Growth Platform as the case may be. It further prescribes disclosure requirements for a Not for Profit Organisation including a requirement for submission statement on utilisation of funds on a quarterly basis by a listed Not for Profit Organisation.

Participation as Financial Information Providers (FIPs) in the Account Aggregator (AA) framework

The SEBI has issued a circular dated August 19, 2022, enabling SEBI-regulated entities such as depositories and asset management companies through their registrar and transfer agents to take part in the Account Aggregator framework as "Financial Information Providers" (FIP).

An Account Aggregator (AA), is a Reserve Bank of India (RBI) regulated Non-Banking Finance Company (NBFC) that facilitates retrieval or collection of financial information, pertaining to a customer, from FIP on the basis of explicit consent of the customer.

The FIPs in the securities markets shall share the "Financial Information" pertaining to securities markets, through the AA only on receipt of a valid consent artifact from the customer through the Account Aggregator. The consent architecture is detailed under Clause 6 of the RBI Master Directions in this regard.

To enable these data flows, the FIPs in the securities markets shall:

- implement interfaces that will allow an Account Aggregator to submit consent artifacts, and authenticate each other, and would enable a secure flow of financial information to the AA
- adopt means to verify the consent including digital signatures, if any, contained in the consent artifact
- implement means to digitally sign the financial information that is shared by them about the customers
- maintain a log of all information sharing requests and the actions performed by them pursuant to such requests

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Circular dated 4 August 2022: Enhanced Guidelines for Debenture Trustees (DTs) and listed issuer companies on security creation and initial Due Diligence (DD)

SEBI, on 3 November 2020, issued guidelines on the creation of security in respect of listed debt securities and DD to be undertaken by DTs (the said circular).

SEBI has now tweaked certain aspects of the said circular and laid down revised requirements relating to encumbrance, creation of security and related DD by DTs details of which are mentioned here under:

- Manner of change in security/ creation of additional security/ conversion of security - A harmonised process of creation of security
  - Before initiating DD, a DT and the listed entity shall enter into an amended debenture trust agreement incorporating the obligations for continuous monitoring of SEBI compliance/provisions.
  - A DT is to carry out DD in the prescribed manner and issue its No Objection Certificate (NOC) with a proposed change in the structure/creation of security.
  - Upon the receipt of NOC, the issuer company is to create proposed security and charge in favour of DT and get the same registered with ROC, pursuant to which, the issuer company and DT are to enter into an amended DT deed with all relevant terms and conditions.
  - Upon execution of the amended DT deed, the issuer company to submit the required documents to the Depositories and Stock Exchanges and a new ISIN shall be allotted.
- Encumbrance on securities for issuance of listed debt securities:
  - Creation of encumbrance on the securities for securing the non-convertible debt securities must be through the depository system only. Further, the circular also provides for the meaning of 'Encumbrance'.
- DD Certificate in case of Shelf Prospectus / Memorandum:
  - In case security details are not finalized at the time of the filing of the draft shelf prospectus/placement memorandum filed by an issuer company, the DT to carry out the DD process and issue a certificate for clauses except that of security creation and issue another certificate after the terms of security are determined/finalised.
- Empanelment of External Agencies by DTs:
  - To empanel external agencies for carrying out DD, the DTs must adopt an empanelment criterion/policy approved by the Board of Directors and formulate a policy on mitigating conflict of interest including a requirement that the empaneled agency have no pecuniary relationship with the issuer company 3 years prior to the issue.

Circular dated 17 August 2022: Guidelines for overseas investment by Alternative Investment Funds (AIFs) and Venture Capital Funds (VCFs)

The circular provides for certain conditions/guidelines for investment by AIFs and VCFs in securities of companies incorporated outside India, key details of which are as under:

- AIFs/VCFs shall make an application for allocation of overseas investment limit in the format provided in a circular. Further, the requirement of the overseas investee company to have an Indian connection is done away with.
- AIFs/VCFs shall invest in an overseas investee company, which is incorporated in a country whose securities market regulator is a signatory to the specified organization which has a Memorandum of Understanding with SEBI.
- AIFs/VCFs shall not invest in an overseas investee company, which is incorporated in a country identified in the public statement of the Financial Action Task Force (FATF)
- The proceeds received upon liquidation of investment made by AIFs/VCFs in an overseas investee company shall be available for reinvestment.
- The transfer/selling of investment by AIFs/VCFs in overseas investee companies can only be made to the entities eligible to make overseas investments.
- The details of the sale/divestment of overseas investment are to be furnished to SEBI in the format and manner prescribed.

Circular dated 26 August 2022: Amendments to guidelines for the preferential issue and institutional placement of units by listed Infrastructure Investment Trusts (InvIT) and Real Estate Investment Trusts (REITs)

SEBI, vide its previous circulars prescribed the guidelines for the preferential issue and institutional placement of units by a listed InvIT/REIT.

Vide this circular, SEBI has amended these guidelines, details of which are mentioned here under:

- Post allotment, the InvIT/REIT must make an application for listing of the units to the stock exchange(s) and the units shall be listed within 2 working days (as against 7) from the date of allotment failing which the issuer shall refund the monies received through verifiable means within 4 working days (as against 20) from the date of the allotment. In case of failure to repay the money, the InvIT/REIT, its investment manager, and director/partner who is an officer in default shall be jointly and severally liable to repay that money with interest at the rate of 15% per annum.

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- The minimum price of frequently traded units of InvIT/REIT to be allotted shall be higher than the followings:
  - 90 trading days' Volume Weighted Average Price
  - 10 trading days' (preceding the relevant date) Volume Weighted Average Price of the related units quoted on the recognised stock exchange preceding the relevant date.
- The maximum number of units that can be allotted to "institutional investors" is restricted to 5 at a price which shall be at least 10 trading days' volume weighted average prices of the related units quoted on a recognized stock exchange preceding the relevant date.
- Preferential issue of units shall not be made to any person [including person belonging to the sponsor(s)] who has sold or transferred any units during the 90 trading days preceding the relevant date. Selling/transferring of units by any person belonging to the sponsor(s) shall make all the sponsor(s) ineligible for allotment of units. The above restriction shall not apply to a sponsor(s), where the preferential issue of units is being made by the InvIT/REIT as full consideration for the acquisition of any asset by it from the sponsor.
- The circular also provides for the meaning of 'Relevant Date', 'Relevant Stock Exchange' and 'Frequently Traded Units'.

MINISTRY OF CORPORATE AFFAIRS (MCA)

Companies (Appointment and Qualification of Directors) Third Amendment Rules, 2022

The MCA vide notification dated 29 August 2022 made amendments to Companies (Appointment and Qualification of Directors) Rules, 2014.

By this notification, e-form DIR-3-KYC and web-form DIR-3-KYC-WEB have been substituted and the format of the same has been provided on the MCA website.

The amendment resulted in additional details which need to be provided such as under the head Verification and Certificate by practising professional in Form DIR-3 KYC amendment has been made in point V where additional liability has been added on the applicant as well as certifying professional under Section 447 of the Companies act, 2013.

The amendment shall come into force from its date of publication in the Official Gazette.

Companies (Removal of Names of Companies from the Register of Companies) Second Amendment Rules, 2022

The MCA vide notification dated 24 August 2022 has made amendments in Companies (Removal of Names of Companies from the Register of Companies) Rules, 2016 to update Form STK-1 - Notice by Registrar for Removal of names of a company from Register of companies (RoC), STK-5 and STK-5A (Public Notice by RoC).

With this amendment, RoC can issue notice for removal of the name of the company if it finds that a company is not carrying any business or operation from the registered office as revealed during the conduct of the physical verification of the registered office of the company u/s 12(9) of the Companies Act, 2013. Accordingly, Form STK-5 and Form STK 5A have been updated.

Under section 12(9) of the Companies Act, 2013, the Registrar, if has a reasonable cause to believe that the company concerned is not carrying on business in a proper manner, can do a physical verification of a company's registered office in the manner as may be prescribed.

Earlier, the MCA had notified the Companies (Incorporation) Third Amendment Rules, 2022 wherein a new rule 25B has been inserted prescribing the manner of physical verification of the registered office of the company.

Circular dated 5 August 2022: The Companies (Accounts) Fourth Amendment Rules, 2022 ("Amended Accounts Rules")

MCA, on 5 August 2022, notified the Amended Accounts Rules by further amending Companies (Accounts) Rules, 2014. The amendment is made in the provisions related to the 'manner of books of account to be kept in electronic mode'.

Key highlights of the Amended Rules are summarised below:

- The Companies that maintain their books of account and other relevant books and papers in electronic mode must maintain in such a way that such records remain accessible in India for further use/reference, **at all the times.**
- The Companies must maintain a system for storage/retrieval/display/printout of the electronic records in the manner deemed appropriate by the companies' Board Members and Audit Committee. Further, the backup of the books of account and other books and papers maintained in electronic mode, including at a place outside India, must be kept in servers physically located in India **on a daily basis** (instead of a periodical basis).
- At the time of filing annual financial statements, the companies are required to provide certain information regarding their service provider viz. name, internet protocol address, location, cloud storage address, etc. **However, where the service provider is located outside India, it is now mandatory for the companies to provide the name and address of the person in control of the books of account and other books and papers, in India.**

Notification dated 18 August 2022: The Companies (Incorporation) Third Amendment Rules, 2022 (Amended Incorporation Rules)

MCA, on 18 August 2022, notified the Amended Incorporation Rules by inserting Rule 25B providing for physical verification of the Registered office of a Company, key highlights of which are summarised below:

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- As per the Amended Rules, the Registrar of Companies (ROC), based upon the information or documents made available on MCA 21, shall visit the address of the registered office of the company and may cause the physical verification of the said registered office in the presence of two independent witnesses of the locality along with the assistance of the local Police, if required.
- The ROC may also cross-verify the documents as filed on MCA 21 in support of the address of the registered office of the company with the same documents collected during the physical verification to check its authenticity.
- Where the registered office of the company is found to be not capable of receiving and acknowledging all communications and notices, the ROC may send a notice to the company/directors, of its intention to remove the name of the company from its records requesting them to send their representations along with copies of relevant documents, if any, within 30 days from the date of the notice, post which ROC may take appropriate actions.

Notification dated 29t August 2022: The Companies (Acceptance of Deposits) Amendment Rules, 2022 (Amended Deposits Rules)

As per the Companies (Acceptance of Deposit) Rules, 2014, companies are required to file with ROC, on or before the 30th day of June of every year, a return furnishing the information relating to acceptance of deposits, as on the 31st day of March of that year, duly audited by the auditor of the company, in form DPT-3.

The Amended Deposit Rules mandate the statutory auditors to certify the form and submit a declaration, in the form itself, stating the fact the 'particular of deposits' and 'particular of liquid assets' as mentioned in the form is true and in accordance with the Companies Act, 2013.

Further, companies are now required to report the disclosures in amended versions of Form DPT-3 and DPT-4.

Notification dated 29 August 2022: The Companies (Registration of Charges) Second Amendment Rules, 2022 (Amended Charges Rules)

The Amended Charges Rules provide that e-forms related to

- creation/modification of charge
- satisfaction of charge
- appointment or cessation of receiver or manager
- application to the central government for extension of time for filing particulars in relation to creation/modification/satisfaction of charge

are now required to be signed by an insolvency resolution professional or resolution professional or liquidator for companies under resolution or liquidation, as the case may be.

Further, the companies are now required to make disclosures in the amended version of Form CHG-1, CHG-4, CHG-6, CHG-8, CHG-9.

RESERVE BANK OF INDIA ("RBI")

Outsourcing of Financial Services - Responsibilities of regulated entities employing Recovery Agents

The RBI has issued a notification dated 12 August 2022, to instruct the Regulated Entities (REs) that it shall be strictly ensured that they or their agents do not resort to intimidation or harassment of any kind, either verbal or physical, against any person in their debt collection efforts, including acts intended to humiliate publicly or intrude upon the privacy of the debtors' family members, referees and friends, sending inappropriate messages either on mobile or through social media, making threatening and/ or anonymous calls, persistently calling the borrower and/ or calling the borrower before 8:00 a.m. and after 7:00 p.m. for recovery of overdue loans, making false and misleading representations, etc.

The instructions mentioned above shall supplement and be read in conjunction with the existing guidelines/directions issued by the RBI, as amended from time to time.

Any violation in this regard by REs will be viewed seriously. This circular shall not apply to microfinance loans covered under 'Master Direction – Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022', dated 14 March 14 2022.

Bilateral Netting of Qualified Financial Contracts - Amendments to Prudential Guidelines

The RBI has issued a notification dated 11 August 2022, to clarify the following points with respect to which RBI has received queries from regulated entities (REs):

- **foreign exchange (except gold) contracts which have an original maturity of 14 calendar days or less are excluded from capital requirements for counterparty credit risk:** the exemption for foreign exchange (except gold) contracts that have an original maturity of 14 calendar days or less shall be applicable to entities calculating the counterparty credit risk under Original Exposure Method without taking the benefit of bilateral netting. Accordingly, the exemption would be applicable only to Regional Rural Banks, Local Area Banks and Co-operative Banks, where the bank has not adopted the bilateral netting framework. For other entities, the exemption shall stand withdrawn.
- **'sold options', provided the entire premium/fee or any other form of income is received/realised, are excluded from capital requirements for counterparty credit risk:** 'sold options', provided the entire premium/fee or any other form of income is received/realised, can be excluded only when such 'sold options' are outside the netting and margin agreements.

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- **For Credit Default Swap transactions where the bank is the protection seller, the exposure is capped at the amount of premium unpaid by the protection buyer:** For Credit Default Swaps where the bank is the protection seller and that are outside netting and margin agreements, the exposure may be capped to the amount of premium unpaid. Banks have the option to remove such credit derivatives from their legal netting sets in order to apply the cap.

This circular shall come into force from immediate effect and is applicable to all Commercial Banks, Co-operative Banks, Standalone Primary Dealers, Systemically Important Non-Deposit taking Non-Banking Financial Companies (NBFC-ND-SIs), Deposit-taking Non-Banking Financial Companies (NBFC-Ds) and Housing Finance Companies (HFCs).

Circular dated 1 August 2022: External Commercial Borrowings (ECB) Policy - Liberalisation Measures

The key highlights from the circular are as follows:

- Eligible ECB borrowers are allowed to raise ECB to USD 1.5bn or equivalent per financial year under the automatic route.
- The all-in-cost ceiling for ECB's has been increased by 100 basis points. The said increase in limit is available only to eligible borrowers of investment grade rating from Indian Credit Rating Agencies (CRAs).
- The relaxations provided by this circular are available for ECBs to be raised till 31 December 2022.

Circular dated 8 August 2022: Authorised Dealer Category-I License eligibility for Small Finance Banks (SFBs)

RBI vide its previous circular permitted SFBs to become Authorised Dealer Category-II in foreign exchange business for its client's requirements.

Vide this circular, RBI now permits scheduled SFBs to be eligible for Authorised Dealer Category-I license subject to completion of at least 2 years of operations as Authorised Dealer Category II and other eligibility norms like the minimum net worth of INR 500cr, must be profit-making in preceding 2 years, no default in maintenance of Cash Reserve Ratio/Statutory Liquidity Ratio during previous 2 years and various other conditions as detailed in Annexure to this circular.

Notifications/Circular dated 22 August 2022: Foreign Exchange Management (Overseas Investment) Rules, 2022 (OI Rules) and Foreign Exchange Management (Overseas Investment) Regulations, 2022 (OI Regulations) and FEMA (Overseas Investment) Directions, 2022 (OI Directions)[1]

The OI Rules, OI Regulations and OI Directions are collectively referred to as "New OI Regime".

Some of the major terms that are redefined/reiterated under the New OI Regime are mentioned here under:

- **'Overseas Investment'** means any investment by a person resident in India in a foreign entity, either directly, through Step Down Subsidiary (SDS) or through a Special Purpose Vehicle.
- **Foreign Entity** - the extant concept of Joint Venture (JV) and Wholly Owned Subsidiary (WOS) is substituted with the concept of foreign entity, which means an entity formed or registered or incorporated outside India, including the International Financial Service Centre (IFSC) in India, that has limited liability [a company or a limited liability partnership (LLP) firm where the liability of the person resident in India is clear and limited]. The foreign entity must be engaged in a bona fide business activity. In case of a foreign entity, being an investment fund or vehicle, duly regulated by the regulator for the financial sector in the host jurisdiction and set up as a trust outside India, the liability of the person resident in India shall be clear and limited not exceeding the interest or contribution in the fund in any manner. Further, the trustee of such fund shall be a person resident outside India.
- **Strategic sector** shall include energy and natural resources sectors such as oil, gas, coal, mineral ores, submarine cable system and start-ups and any other sector or sub-sector as deemed fit by the Central Government. The restriction of the limited liability structure of foreign entities shall not be mandatory for entities with core activity in any strategic sector. Accordingly, Overseas Direct Investment (ODI) can be made in such sectors in unincorporated entities as well. AD banks may allow remittances for ODI in the strategic sector after ensuring that the Indian entity has obtained the necessary permission from the competent authority, wherever applicable.
- **Indian Entity:** Under the erstwhile regulations, all investors from India in a foreign entity were together considered as an 'Indian Party', but now each investor entity will be separately considered as an Indian entity (viz a company, a body corporate, LLP, and a partnership firm)
- **Control means** the right to appoint a majority of the directors or to control the management or policy decisions exercisable by a person or persons acting individually or in concert, directly or indirectly, including by virtue of their shareholding or management rights or shareholders' agreements or voting agreements that entitle 10% or more of voting rights or in any other manner in the entity.

[1] We, at BDO India, have summarised the New OI Regime in detail and got it published on 29th August 2022 for wider accessibility link of which is here - Regulatory Alert - New Overseas Investment Regime - BDO

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- **Subsidiary / SDS** of a foreign entity means an entity in which the foreign entity has control and the structure of such subsidiary/SDS shall also have limited liability where the foreign entity's core activity is not in strategic sector. The investee entities of the foreign entity where such foreign entity does not have control (as defined above) shall not be treated as SDSs and hence need not be reported.
- **Overseas Direct Investment** means
  - acquisition of any unlisted equity capital or subscription as a part of the Memorandum of Association of a foreign entity
  - investment in 10% or more of the paid-up equity capital of a listed foreign entity, or
  - investment with control even if an investment is less than 10% of the paid-up equity capital of a listed foreign entity (Any investment, once treated as ODI, will always be treated as ODI despite the investment/control falling below the above-mentioned limits)
- **Overseas Portfolio Investment (OPI)** means an investment, other than ODI, in foreign securities subject to the specified conditions and exceptions, some of which are mentioned hereunder:
  - No OPI shall be made in any unlisted debt instruments, any security which is issued by a person resident in India who is not in an IFSC, Non-RBI derivatives, any commodities, etc.
  - Once an OPI is made by a person resident in India in the listed equity capital, shall always be treated as OPI, even after delisting.
  - OPI can be made in form of reinvestment as well without following any repatriation provision subject to given terms, etc.
- **Financial Commitment (FC)** by a person resident in India means the aggregate amount of investment by way of ODI, debt other than OPI and non-fund-based facility or facilities extended by it to all foreign entities, all of which are taken together at the time of undertaking such commitment, shall not exceed **400%.**
  An Indian entity may lend or invest in any debt instruments issued by a foreign entity or extend the non-fund-based commitment to or on behalf of a foreign entity, including overseas SDSs of such Indian entity, subject to specified conditions viz. the Indian entity is eligible to make ODI and has made the same in a foreign entity and has acquired control in the foreign entity on or before the date of making such FC. Prior approval of RBI is still required in cases where the FC by an Indian entity, exceeds USD 1 billion (or its equivalent) in an FY even when the total FC of the Indian Entity is within the eligible limit under the automatic route (i.e., 400% of the net worth of the Indian entity).
- **Equity capital** means equity shares or perpetual capital or instruments that are irredeemable or contribute to the non-debt capital of a foreign entity in fully and compulsorily convertible instruments.

Some of the significant changes brought through this new OI Regime are mentioned hereunder:

- FC by way of guarantee and debt:
  - The New OI regime lists down the types of guarantees that can be issued to or on behalf of a foreign entity/its SDS in which the Indian entity has acquired control through a foreign entity
  - An Indian entity can lend or invest in any debt instrument issued by a foreign entity provided such loans are duly backed by a loan agreement and the rate of interest meets arm's length standard.
  - Further, if the guarantee is extended by a group company, it will be counted towards the utilisation of that group company's FC limit independently, but where the guarantee is extended by a resident Indian promoter, it will be counted towards the FC limit of the Indian entity.
- **FC by way of pledge/charge:**
  - The new ODI regime has relaxed the conditions for leveraging offshore securities as well as onshore assets of the Indian entity, by permitting the creation of security in favour of an overseas lender.
  - An Indian entity, which has made ODI by way of investment in equity capital in a foreign entity, may
    - Pledge the equity capital of the foreign entity /its SDS outside India
    - Create charge on its assets (other than above) in India [including the assets of its group company or associate company, promoter and/or director]
    - Create a charge on the assets outside India of the foreign entity/ its SDS outside India.

  The circular also provides for details on in whose favour the charge can be created, facilities to be availed and the value of the charge/amount of facility.
- **Prohibited ODI**

  Basis activity – ODI is prohibited in a foreign entity engaged in
  - real estate activity
  - gambling in any form
  - dealing with financial products linked to the Indian rupee without specific approval of the RBI

  ODI in start-ups - Any ODI in start-ups recognised under the laws of the host country or host jurisdiction, shall be made by an Indian entity only from the internal accruals from the Indian entity/investors.
- **Overseas Direct Investment - Foreign Direct Investment (FDI) Structure.**
  The New OI Regime allows investment in a foreign entity that has a step-down subsidiary in India (either at the time of investing or anytime thereafter), even if such investment results in a structure having up to 2 layers of subsidiaries (beyond 2 layers is prohibited). The above permitted ODI-FDI in the same structure with restriction on a maximum of two layers of subsidiaries is not applicable to banking companies, NBFCs, insurance companies and government companies.

REGULATORY UPDATES

- **Overseas investment by resident individuals**
  - Where a resident individual has made ODI without control in a foreign entity that subsequently acquires or sets up an SDS, such resident individual shall not acquire control in such foreign entity.
  - Overseas investment by way of capitalisation, swap of securities, rights/bonus, gift and inheritance shall be categorised as ODI or OPI.
  - Any investment by way of sweat equity shares, Employee Stock Options, etc. up to 10% of the paid-up capital/stock of the foreign entity and does not lead to control, such Investment shall be categorised as OPI.
  - Resident individuals are not permitted to transfer any overseas investment by way of gift to a person resident outside India.
- **Overseas investment by a person resident in India, other than an Indian entity or a resident individual**
  Mutual Funds and VCFs/AIFs registered with SEBI are allowed to invest overseas in securities within an overall cap of USD 7bn and USD 1.50bn, respectively. Further, a limited number of qualified MFs are permitted to invest cumulatively up to USD 1bn in overseas Exchange Traded Funds, as may be permitted by SEBI.

  Such investment shall be considered OPI irrespective of whether the securities are listed or not.
- **Overseas investment in an IFSC in India by a person resident in India.**
  A person resident in India, being an Indian entity or a resident individual, may invest in the units of an investment fund or vehicle set up in an IFSC as OPI. The restriction of making ODI only in an operating foreign entity or not making ODI in a foreign entity engaged in financial services activity by resident individuals, shall not apply to an investment made in IFSC. Such investment, however, shall not be made in any foreign entity engaged in banking or insurance.
- **Acquisition or transfer of immovable property outside India.**
  An Indian entity having an overseas office are permitted to acquire immovable property outside India for the business and residential purposes of its staff, provided total remittances do not exceed the limits as laid down for initial and recurring expenses.

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA ("ICAI")

Guidance Note on Tax Audit under Section 44AB of the Income-tax Act, 1961 AY 2022-23

The ICAI has revised the Guidance Note on Tax Audit under Section 44AB of the Income-tax Act, 1961 and published the same on 14 August 2022. Direct Taxes Committee (DTC) of the ICAI issued "Guidance Note on Tax Audit u/s 44AB of the Income-tax Act, 1961".

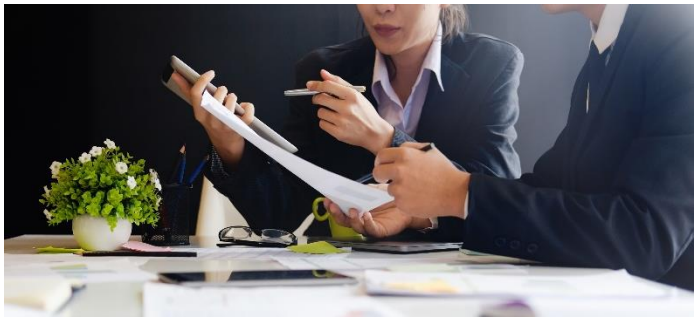
The Guidance Note provides guidance to members for the conduct of tax audits, making of reports and related matters. This publication was last revised in the year 2014. Thereafter, in the year 2018, a publication titled 'Implementation Guide w.r.t. Notification No. 33/2018 dated 20.07.2018 effective from 20.08.2018' was released by the DTC of ICAI. There have been substantial changes in provisions of law and clauses included in the particulars to be furnished in Form No. 3CD since the last publication. Accordingly, the Guidance Note has been updated and incorporated all the changes in the desired clauses which has been taken place in the taxation laws, notifications, circulars, etc. after due deliberations amongst eminent experts and suggestions received from various stakeholders.

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY OF INDIA (IRDAI)

Applicability of Service Tax/ GST on service provided by IRDAI to Insurance intermediaries

The IRDAI has issued a circular dated 11 August 2022 wherein it has advised all insurance intermediaries to ensure that any payment made to IRDAI towards fees/ charges, etc. paid or payable on or after 12 August 2022 shall be made along with GST @ 18%. Instructions in respect of Service Tax/ GST for the earlier period will be issued separately.

Further, all the insurance intermediaries are directed to submit a copy of the GST Registration Certificate to the IRDAI by 20 August 2022.



TAX UPDATES
Direct Tax

CIRCULARS/ NOTIFICATIONS/PRESS RELEASE

CBDT notifies Form 29D for claiming refund of taxes withheld under section 195 of the Income-tax Act, 1961 (IT Act)

Finance Act, 2022 inserted Section 239A in the IT Act to provide for refund of taxes withheld under section 195 (other than interest income), if the deductor claims that no tax was to be withheld. Such a claim is to be made by filing an application within 30 days from the date of payment of the TDS amount. In this regard, the Central Board of Direct Taxes (CBDT) has recently notified Form 29D by inserting Rule 40G in the Income-tax Rules, 1962. The application is to be accompanied by a copy of an agreement or other arrangement referred to in section 239A of the IT Act. Form 29D seeks details of the following:

- Taxpayer (viz., status, residential status, PAN or Aadhar No., email ID and mobile number)
- Deductee (viz., Name, status, PAN (if available), email ID, mobile number, resident country)
- Agreement or arrangement (viz., Signing date, effective date, validity)
- Transaction on which tax, not deductible has been deducted (viz., Amount, transaction date, payment date, mode, nature of the transaction)
- Taxes withheld (viz., TDS amount, tax withholding date, challan details)
- The reason why no tax is required to be withheld on the income in the relevant transaction
- Where tax withheld on a similar transaction has been refunded in 3 years prior to the relevant previous year and details thereof (viz., Relevant Assessment Year, transaction date, taxes withheld amount, tax refund amount, order of CIT(A) or AO)

[Notification No. 98/2022, dated 17 August 2022]

COVID-19 related Notifications

Re. Exemption from perquisite under section 17(2)

The Central Government has notified that expenditure incurred for treatment of COVID-19 or any illness related to COVID-19 of the employee or any member of his family (met by the employer) to be outside the purview of perquisite, the employee should furnish the following documents to the employer:

- the COVID-19 positive report of the employee or family member, or medical report if clinically determined to be COVID-19 positive through investigations, in a hospital or an in-patient facility by a treating physician of a person so admitted
- all necessary documents of medical diagnosis or treatment of the employee or his family member for COVID-19 or illness related to COVID-19 suffered within six months from the date of being determined as COVID-19 positive

- a certification in respect of all expenditure incurred on the treatment of COVID-19 or illness related to COVID-19 of the employee or of any member of his family.

This notification shall be deemed to have come into force from the 1st day of April 2020 and shall apply in relation to the assessment year 2020-2021 and subsequent assessment years.

[Notification No. 90/2022, dated 5 August 2022]

Re. Exemption from section 56(2)(x)

Where the employee is alive

The Central Government has notified the following conditions for claiming exemption from section 56(2)(x) of the IT Act in respect of expenditure incurred for treatment of COVID-19 or any illness related to COVID-19 of the employee or any member of his family (met by the employer):

- The individual shall keep a record of the following documents, namely:
  - the COVID-19 positive report of the individual or his family member, or medical report if clinically determined to be COVID-19 positive through investigations in a hospital or an in-patient facility by a treating physician for a person so admitted
  - all necessary documents of medical diagnosis or treatment of the individual or family member due to COVID-19 or illness related to COVID-19 suffered within six months from the date of being determined as a COVID-19 positive
- Statement of any amount received for any expenditure actually incurred by an individual for his medical treatment or treatment of any member of his family, for any illness related to COVID-19 for the purposes of clause (XII) of the first proviso to section 56(2)(x) of the IT Act shall be verified and furnished in Form No. 1
- The details of the amount received in any fiscal year shall be furnished in Form No. 1 to the Income Tax Department within nine months from the end of such fiscal year or 31 December 2022, whichever is later

[Notification No. 91/2022, dated 5 August 2022]

Where the employee has died due to COVID-19

The Central Government has notified the following conditions for claiming exemption from section 56(2)(x) of the IT Act in respect of the amount received by family members due to COVID-19 death of an employee/individual from its employer/any person:

TAX UPDATES
Direct Tax

- The death of the individual should be within six months from the date of testing positive or from the date of being clinically determined as a COVID-19 case, for which any sum of money has been received by the member of the family
- The family member of the individual shall keep a record of the following documents:
  - the COVID-19 positive report of the individual, or medical report if clinically determined to be COVID-19 positive through investigations in a hospital or an inpatient facility by a treating physician
  - a medical report or death certificate issued by a medical practitioner or a Government civil registration office, in which it is stated that the death of the person is related to coronavirus disease (COVID-19)
- Statement of any sum of money received by a family member of the deceased person from the employer of the deceased person or from any other person or persons, on account of death due to COVID-19 for the purposes of clause (XIII) of the first proviso to section 56(2)(x) of the IT Act shall be verified and furnished in Form A
- The details of the amount received in any financial year shall be furnished in Form A to the Tax Officer within nine months from the end of such fiscal year or 31 December 2022 whichever is later

[Notification No. 92/2022, dated 5 August 2022]

Transfer of certain Bullion Depository Receipt to be tax neutral

Subject to fulfillment of prescribed conditions, Section 47(viiab) of the IT Act exempted the transfer of certain capital assets from the definition of taxable transfer and consequently, no capital gains tax is payable on the transfer of such capital assets. This section was amended by Finance (No. 2) Act, 2019 to give powers to Central Government to notify any other securities (other than the ones listed in this section) which would be entitled to the exemption from capital gains tax. In March 2020, the Central Government notified certain securities with effect from 1 April 2020. Recently, the Central Government has notified Bullion Depository Receipt with underlying bullion. The notification also defines the term 'Bullion Depository Receipt with underlying bullion'.

[Notification No. 89/2022 dated 3 August 2022]

CBDT notifies conditions to claim exemption on the transfer of offshore derivative instruments or over-the-counter derivatives in IFSC.

The Finance Act 2021 had inserted a clause (4E) in section 10 of the IT Act to exempt, subject to certain conditions, any income accrued or arisen to, or received by a non-resident if such income is a result of a transfer of non-deliverable forward contracts and such contracts are entered into with an offshore banking unit of an International Financial Services Centre (IFSC).

Finance Act, 2022 amended section 10(4E) of the IT Act to bring offshore derivative instruments and over-the-counter derivatives within its ambit. Consequently, amendments are also incorporated Rule 21AK which provides the conditions for claiming exemption under sec 10(4E) of the IT Act. The Notification also incorporates the definition of the terms "derivative", "offshore derivative instrument" and "over-the-counter derivatives".

[Notification No. 87/2022 dated 1 August 2022]

CBDT expands the scope of the exemption for Section 206C(1G)

As per Section 206C(1G) of the IT Act, the tour operator shall be required to collect tax (TCS) at the rate of 5% in respect of the overseas tour program package. CBDT had issued a notification to the exempt non-resident individual visiting India from the applicability of section 206C(1G) of the IT Act. Recently, the CBDT issued another Notification superseding this notification. As per this Notification, section 206C(1G) of the IT Act shall not apply to a non-resident buyer who does not have a Permanent Establishment (PE) in India.

To read our detailed analysis, please go to:
https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-expands-the-scope-of-exemption-for-section-206c(1g)

[Notification No. 99/2022, dated 17 August 2022]

CBDT revises timeline for furnishing Form 67

A resident taxpayer is taxed on his global income. On the foreign-sourced income, the Source Country may levy tax. To grant credit for such taxes, Foreign Tax Credit (FTC) Rules (i.e. Rule 128 of IT Rules) were introduced. One of the requirements for claiming FTC is filing Form 67 before the due date of furnishing the tax return under section 139(1) of the IT Act. Due to various reasons, there were instances where Form 67 could not be filed before the prescribed due date. Hence, representations were made before the CBDT to relax the timeline for submission of Form 67. In this regard, recently, the CBDT has issued a notification relaxing the time limit for furnishing Form 67 by substituting existing Rule 128(9) of the IT Rules.

To read our detailed analysis, please go to:
https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-revises-timeline-for-furnishing-form-67

[Notification No. 100/2022, dated 18 August 2022]

JUDICIAL UPDATES

HC's jurisdiction depends upon the tax officer passing the order

The taxpayer is engaged in the business of manufacturing writing and printing paper. For the fiscal year 2007-2008, the taxpayer files its tax return before Tax Officer, New Delhi. The aforesaid return was selected for scrutiny assessment which was completed vide assessment order dated 30-12-2010.

TAX UPDATES
Direct Tax

Against the assessment order passed by the Tax Officer, the taxpayer filed an appeal before the First Appellate Authority, New Delhi and subsequently to Delhi Tax Tribunal wherein the issue was decided in favour of the taxpayer. Against this order, the Tax Authority filed an appeal before Punjab and Haryana High Court.

While the matter was pending before the First Appellate Authority, a search operation was carried out at the office and factory of the taxpayer in Chandigarh and certain places of Punjab by the Directorate of Income-tax (Investigation), Ludhiana. Further, after the search operation, the Commissioner of Income-tax (Central), Ludhiana, centralised taxpayer's matters and transferred the same to Central Circle, Ghaziabad by passing an order under section 127 of the IT Act.

In view of the above transfer under Section 127, the Deputy Commissioner of Income Tax, Central Circle, Ghaziabad, proceeded further and passed an assessment order against which the taxpayer filed an appeal before the First Appellate Authority, Kanpur who granted the relief to the taxpayer. The Tax Authority filed an appeal before the Delhi Tax Tribunal. As the decision of the Delhi Tax Tribunal in the case of the taxpayer with respect to an earlier year was already available, the Delhi Tax Tribunal followed the said judgment and dismissed the appeal filed by the Tax Authority. Hence, the Tax Authority filed an appeal before Punjab & Haryana High Court (P&H HC).

The P&H HC held that notwithstanding the order under Section 127 of the IT Act which transferred the cases of the taxpayer to Chandigarh, the P&H HC would not have jurisdiction as the Tax Officer who passed the initial assessment order is situated outside the jurisdiction of the High Court. P&H HC relied on various judicial precedents[1]. The Tax Authority filed an appeal before the Supreme Court.

Apart from filing an appeal before Supreme Court, the Tax Authority also filed an appeal before Delhi High Court (Delhi HC) against the Delhi Tax Tribunal order as P&H HC had dismissed the appeal on account of lack of jurisdiction. For arriving at this conclusion, Delhi HC relied on various judicial precedents[2]. In these decisions, the Delhi HC had taken a view that when an order of transfer under Section 127 of the IT Act is passed, the jurisdiction gets transferred to the High Court within whose jurisdiction the situs of the transferee officer is located. Against this decision, the Revenue Authority filed an appeal before the Supreme Court.

Supreme Court held that appeals against every decision of the Tax Tribunal shall lie only before the High Court within whose jurisdiction the Tax Officer who passed the order is situated.

Even if the case or cases of a taxpayer are transferred in the exercise of power under Section 127 of the IT Act, the High Court within whose jurisdiction the Tax Officer has passed the order shall continue to exercise the jurisdiction of the appeal. This principle is applicable even if the transfer is under Section 127 for the same assessment year(s). While coming to this conclusion, Supreme Court made the following observations:

- A judicial remedy must be effective, independent and at the same time certain. Certainty of the forum would involve unequivocal vesting of jurisdiction to adjudicate and determine the dispute in a named forum
- Section 127 occurs in Chapter XIII of the IT Act which deals with Tax Authorities. In the same chapter, Section 116 enlists the Tax Authorities and Section 120 of the IT Act specifies the jurisdiction of such Authorities. While Section 124 of the IT Act specifically speaks of the jurisdiction of Tax Officers, Section 127 of the IT Act enables a higher authority to transfer a 'case' from one Tax Officer to another Tax Officer. All these provisions in Chapter XIII of the IT Act only relate to the executive or administrative powers of Tax Authorities
- The vesting of appellate jurisdiction has no bearing on judicial remedies provided in Chapter XX of the IT Act before the Tax Tribunal and the High Court
- A decision of a High Court is binding on subordinate courts as well as tribunals operating within its territorial jurisdiction. It is for this very reason that the Tax Officer, First Appellate Authority and the Tax Tribunal operate under the concerned High Court as one unit, for consistency and systematic development of the law
- The decisions of the High Court in whose jurisdiction the transferee Tax Officer is situated do not bind the Tax Authorities or the Tax Tribunal which had passed orders before the transfer of the case has taken place. This creates an anomalous situation, as the erroneous principle adopted by the tax authority or the Tax Tribunal, even if corrected by the High Court outside its jurisdiction, would not be binding on them
- The legal structure under the IT Act commencing with the Tax Officer, the First Appellate Authority, Tax Tribunal and finally the High Court under Section 260A of the IT Act must be seen as a linear progression of judicial remedies. The culmination of all these proceedings in the question of law jurisdiction of the High Court under Section 260A of the IT Act is of special significance as it depicts the overarching judicial superintendence of the High Court over Tribunals and other Authorities operating within its territorial jurisdiction
- The power of transfer exercisable under Section 127 of the IT Act is relatable only to the jurisdiction of the Tax Authorities. It has no bearing on the Tax Tribunal, much less on a High Court
- As a matter of principle, the transfer of a case from one judicial forum to another judicial forum, without the intervention of a Court of law is against the independence of the judiciary

[Pr.CIT, Chandigarh vs. M/s ABC Papers Ltd, Civil Appeal No. 4252/2022 (Supreme Court)]

[1] CIT vs. Motorola India Ltd (2010) 326 ITR 156 (P&H)
CIT(Central) vs. M/s Parabolic Drugs Ltd (ITA No. 49 of 2012) (P&H)
[2] CIT vs. Sahara India Financial Corporation Ltd (2007) 294 ITR 363 (Del)
CIT vs. Aar Bee Industries Ltd (2013) 357 ITR 542 (Del)

TAX UPDATES
Direct Tax

Safe Harbour of 10% for section 43CA of the IT Act to apply retrospectively

A taxpayer is a builder and developer. For the fiscal year 2014-2015, the tax officer considered stamp duty value while computing gains from the sale of property by applying section 43C[3] of the IT Act. The taxpayer contended that the difference between the sales consideration and stamp duty value is less than the safe harbour rate of 10%. The First Appellate Authority upheld the Tax Officer's order. Aggrieved, the taxpayer filed an appeal before the Tax Tribunal. The Tax Tribunal while granting relief to the taxpayer made the following observations:

- The intent of the legislature is to provide relief to the taxpayer in case such difference is less than 10% which has been brought into effect from 1 April 2021 thereby providing benefit to the taxpayer. This being the beneficial provision therefore will even have a retrospective effect and would apply to the fiscal year 2014-15.
- If a fresh benefit is provided by the Parliament in an existing provision, then such an amendment should be given retrospective effect

[Sai Bhargavanath Infra vs. ACIT (ITA No. 1332/Pun/2019)(Pune Tax Tribunal)]

The limit of 4 years for filing a rectification application to apply to intimation issued under section 143(1) of the IT Act

CPC passed an intimation dated 28 January 2012 under section 143(1) of the IT Act. Against this intimation, the taxpayer filed a rectification application on 6 March 2017. The rectification application was rejected on the ground that the same was filed after the expiry of 4 years from the year in which the intimation was issued (i.e. FY 2011-2012). Aggrieved, the taxpayer filed an appeal before the First Appellate Authority which dismissed the appeal. Hence, the taxpayer filed an appeal before the Hyderabad Tax Tribunal which held that the limitation of rectification under section 154(7) of the IT Act is 4 years even for the intimation. While coming to this conclusion, Hyderabad Tax Tribunal made the following observations:

- The sum and substance of the creative interpretation were that literal interpretation is to be avoided if it leads to an absurdity. The interpreting authority is required to think what was the purpose for which the statute was enacted and shall keep thinking like a legislature and find out what the statute wanted to correct/address the issues. After understanding the statute in the above manner the statute is to interpretation and decide the issue.
- If we look into the purpose, object, text, and context of section 154(7) of the IT Act, then it would be clear that the purpose of providing a limitation of 4 years was to give certainties and finality to the order passed by the CPC/Tax Officer. If we read that the limitation provided under section 154(7) of the IT Act is not be available in the case of passing of any intimation to rectify the same, then chaos would happen and unlimited power would be available to the Tax Officer/CPC to rectify the mistake even after the lapse of 4 years.

[Zintec Software (P) Ltd. vs. DCIT (ITA No. 1690/Hyd/2018)(Hyderabad Tribunal)]

SC reiterates that taxpayer needs to satisfy conditions specified in section 36(1)(vii) and section 36(2) of the IT Act for claiming bad debts

As per section 36(2) of the IT Act, Bad Debts written off can be allowed as a deduction only if such write-off was considered while computing total income – either in the same fiscal year in which the write-off is done or in any of the earlier fiscal year. Section 36(1)(vii) of the IT Act provides that subject to section 36(2) of the IT Act, the debt should be actually written off in the books of accounts for claiming the deduction of bad debts. The taxpayer is not required to show the steps undertaken by it to recover the debt before they are written off. Recently, Supreme Court reiterated the law on the deductibility of bad debts. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-sc-reiterates-that-taxpayer-needs-to-satisfy-conditions-specified-in-section-36(1

[Pr.CIT vs Khyati Realtors Pvt. Ltd [SLP(Civil) No. 672 of 2020) (Supreme Court)] 4

[3] Section 43CA of the Act provides that where a consideration received or accruing as a result of the transfer by taxpayer of land or building or both held as stock-in-trade, is less than the value adopted or assessed or assessable by any authority of a State Government for the purpose of payment of stamp duty in respect of such transfer, the difference will be taxed as deemed income

TAX UPDATES
Transfer Pricing

Tax Tribunal deletes TP-adjustment for a write-off of accrued interest and bad debts from AE in the absence of any prescribed method adopted by the TPO:

The taxpayer is engaged in the manufacturing and sale of bulk drugs and other pharmaceutical products. As on 31 March 2008, a foreign loan was given by the taxpayer to the associated enterprise (AE) for USD 22.61mn. Out of this, the taxpayer had converted a USD 4.96mn loan into equity. However, given the circumstances that the product pricing has deteriorated substantially due to stiff competition in the market and the AE went into losses, the taxpayer decided to write off the accumulated interest on these loans. Bad Debts were also written off w.r.t to another subsidiary due to incurring losses. Transfer Pricing Officer (TPO) adjusted respect for a write-off of accrued interest on loans and bad debts. TPO had taken the view that the taxpayer could have converted these receivables into equity as was done in the case of loans advanced to AE. The TPO, therefore, treated the ALP of these two transactions at NIL and made an adjustment. Aggrieved thereby, the taxpayer filed objections before the Dispute Resolution Panel (DRP). DRP upheld the adjustment. The taxpayer filed an appeal before the Hyderabad Tax Tribunal.

Tax Tribunal decision:

The Hyderabad Tax Tribunal deleted the TP adjustment made by the TPO in respect of the write-off of accrued interest and bad debts. Tax Tribunal observed that for determination of the ALP of the written-off transactions, the TPO did not refer to any method contemplated under section 92C(1) of the Act. TPO simply stated that any unrelated commercial enterprise working at arm's length would have made all efforts to recover all its dues. Tax Tribunal relied on the decision of Mumbai ITAT in the case of Henkel Chembond Surface Technologies Ltd and Kellogg India (P) Ltd which held that TPO's approach in determining ALP without prescribing to statutory provisions is unsustainable. If TPO simply determines the ALP of the transaction as NIL, without applying any prescribed method, such an approach of the TPO is not in accordance with the statutory provisions. The view taken in these 2 decisions was squarely applied to the facts of this case.

The Tax Tribunal pointed out that it fails to understand how merely conversion of the accumulated interest and bad debts into equity would amount to their recovery. It is the settled principle of law that the Revenue officers cannot sit in the armchair of the businessman while taking decisions based on business expediency. When the Revenue accepted the TNMM in respect of the sales and purchases and the CUP method in respect of the interest received on loans and reimbursement of expenses, the writing-off of these two amounts are subsumed into the transactions of receipt of interest on loans and it does not necessitate any separate benchmarking.

Tax Tribunal thus allowed the taxpayer's appeal.

Aurobindo Pharma Ltd Vs. DCIT [TS-544-ITAT-2022(HYD)-TP]

Tax Tribunal holds admin/IT support services availed from AE as not stewardship services:

The Taxpayer is a 100% subsidiary of Almatis Holdings GmbH, Germany and is primarily engaged in the manufacturing of alumina-based refractories and ceramic raw materials. The taxpayer had availed certain administrative support services and IT support services from AE which was held by TPO to be in the nature of stewardship service and hence determining ALP at NIL. TPO also rejected foreign AE as the tested party. The taxpayer filed objections before DRP which upheld the TP order. Against the said additions, the taxpayer filed an appeal before the Kolkata Tax Tribunal.

Tax Tribunal decision:

With regard to the administrative support services and IT support services which were held by TPO to be in the nature of stewardship services, the Tax Tribunal concluded that the finding of the Honorable Jurisdictional High Court for AY 2012-2013 and 2013-2014 would be squarely applicable in this case. In such a decision, Tax Tribunal held that the taxpayer does not have a full capacity to provide a range of services to its business and to the personnel working for it. In the interests of economy and efficiency, the taxpayer desired to obtain these services from its associated enterprise which has expert resources in commercial, financial, accounting and other matters which would be employed for the benefit of the taxpayer. The taxpayer would have access to the resources and would pay appropriate consideration which would be commensurate with the amount paid to third-party service providers. The practice of multinational enterprises providing intra group services is a global practice wherein, various activities are frequently concentrated for the benefit of the entire group. Since the multinational group operates globally, such concentration is essential to be able to react most flexibly and cost-effectively.

The taxpayer had also established (i) the nature and quantum of services, (ii) that such services were provided in order to meet specific needs of the taxpayer and (iii) the economic and commercial benefit derived by the taxpayer. The Tax Tribunal thus allowed the taxpayer's plea, noting that Revenue could not controvert the fact that administrative support services and IT support services were not in the nature of stewardship services.

The Kolkata Tax Tribunal also upheld the selection of foreign AE as a tested party relying on a decision of the jurisdictional High Court in the taxpayer's own case for AY 2012-2013 and 2013-2014.

TAX UPDATES
Transfer Pricing

High Court had upheld Tribunal's finding that the taxpayer, being a more complex entity (as its operation entailed entrepreneurial function and related risks), should not be considered as a tested party and that foreign AE (performing simpler functions and not assuming any significant risks), could be treated as a tested party being the least complex party.

Almatis Alumina Pvt. Ltd Vs. DCIT [TS-550-ITAT-2022(Kol)-TP]

TAX UPDATES
Indirect Tax

GOODS & SERVICE TAX

JUDICIAL UPDATES

ORDERS BY AUTHORITY FOR ADVANCE RULING (AAR)

Supplies between Cost Centres considered 'supply' if the activities are distinct from each other

Facts of the case

- M/s. Hyundai Rotem Company ('Taxpayer') is a foreign company incorporated in South Korea and is engaged in manufacture, supply, testing, commissioning, and training in respect of rolling stock. The Taxpayer entered into a contract with Delhi Metro Rail Corporation Limited ('DMRC') for design, manufacture, supply, testing, commissioning, and training of passenger rolling stock and supply of spares & manuals;
- Taxpayer was required to undertake supply of various goods and services to DMRC in a phased manner. The whole of works was apportioned among various cost centres 'A' to 'H' under tender documents which forms part of the contract;
- DMRC disputed the nature of supply and applicable rate of GST, contending that the supply made by Taxpayer under the contract is a 'composite supply' with the principal supply being the "supply of rolling stock" whereas, the supplies under the cost centre 'D' to 'G' are incidental/ancillary to the principal supply;
- Owing to the aforesaid difference of opinion, the differential amount of tax was withheld by DMRC.

Questions before the AAR

- Whether supplies made under cost centres D, G, H (to the extent of training services) to DMRC are to be considered as independent supply of goods or services or as the 'composite' supply, the principal supply being "supply of rolling stock" along with applicable GST rate?

Contention of the Taxpayer

- Taxpayer submitted that the supplies made under cost centres D, G and H (H1 to H5) are not composite to the supplies under cost centres B & C and are as such independent supplies;
- Reliance is placed on the decision of the Hon'ble Supreme Court in the case of Bharat Sanchar Nigam Limited vs Union of India [2006 (2) STR 161 (SC)] wherein, the Hon'ble Apex Court had laid down the "dominant nature test" principle for a transaction to qualify as composite transaction;
- Further, the principles emerging from the above judgment were also relied upon by CBEC in its circular no:334/1/2012-TRU dated 16 March 2012, wherein the CBEC clarified as under:
- "*The test whether a transaction is a 'composite transaction' is that did the parties intend or have in mind that separate rights arise out of the constituent contract of sale and contract of service. If no, then such transaction is a composite transaction even if the contracts could be disintegrated.*"

- Hence, in case the parties to the contract intend or have in mind that separate rights arise out of the constituent contract of sale and contract of sale, then the transaction is not a composite transaction;
- Reliance also may be placed on the decision of the Apex Court in the case of Mahindra & Mahindra Limited [1995 (2) SCR 595] wherein it was held that a contract has to be interpreted in a manner from the apparent tenor of the agreement and apparently it has to be accepted as the real state of affairs;
- Further, reference here is made to Gannon Dunkerley & Co. [1958 AIR SC 560] wherein the Hon'ble Apex Court held that there can be two separate contracts though a single instrument may embody them;
- In the instant case, the scope of activities to be undertaken has been clearly demarcated in the contract, and accordingly, each cost center is making separate supplies based on their defined scope of work. Therefore, for the purpose of invoicing, works performed under each respective cost centre is a criterion and on fulfillment of the same invoices are raised accordingly;
- Reliance is also placed on CBIC circular no:47/21/2018-GST, dated 8 June 2018, wherein the CBIC in the context of servicing of cars involving both supply of goods (spare parts) and services (labour), where the value of goods and services are shown separately, has clarified that where the value of such goods and services supplied are shown separately, the goods and services would be liable to tax at the rates as applicable to such goods and services separately;
- The supplies made under disputed cost centres are independent to each other since cost centre 'D' covers the independent activity of "installation service" (SAC 9987), while cost centre 'G' covers an independent supply of spares. Cost centre 'H' pertains to the independent service of training of operation and maintenance personnel;
- The train cars fall within the residuary category of "goods nowhere else classified" and installing and commissioning the same at DMRC's depots merits classification under the heading "Installation services of goods nowhere else classified";

TAX UPDATES
Indirect Tax

- Taxpayer highlighted the recent Advance Ruling of Karnataka in case of Assistant Commissioner of Central Tax, Bangalore vs M/s BEML Limited [2021- VIL-42-AAAR]. In this ruling, the contract entered between M/s BEML Limited ("BEML") and M/s Bangalore Metro Rail Corporation Limited ("BMRCL") for supply of standard gauge intermediate cars also contained various cost centres such as preliminaries and general requirement for rolling stock including design, delivery and receipt of offshore manufacturing, delivery and receipt of indigenous manufacturing, commissioning and acceptance of cars in depot etc.;
- While AAR Karnataka had taken a view that supplies under multiple cost centers would be treated as composite supply, but the AAAR Karnataka had set-aside the aforesaid ruling and concluded that supplies made under cost centers C, D, E and G are to be considered as independent supplies of goods and services.

Observations & Ruling by the AAR

- The AAR noted that the facts and circumstances brought-out in the application are similar to those on which advance ruling was sought by BEML, supra. The matter was agitated before the Hon'ble Karnataka High Court wherein stay of demand was not granted;
- In the absence of stay in the referred case, AAR in the instant case as well followed the observations drawn by the AAAR, Karnataka.
- Consequently, the supplies made by the disputed cost centres of the contract are not to be considered as 'composite supply'. The ruling is subject to the outcome of the judgment of the Hon'ble High Court of Karnataka in the appeal filed by BMRCL.

[AAR-Karnataka, M/s. Hyundai Rotem Company 2022-VIL-216-AAR-Karnataka-GST dated 12 August 2022]

ITC availed only to the extent services utilised for business purposes

Facts of the case

- M/s. Malabar Cements Limited ('Taxpayer') is a public sector company having registered office in the state of Kerala;
- The Taxpayer has been allotted earthwork in embarkment, cutting and bridge approaches etc. of Central Railway.

Questions before the AAR

- Whether Input Tax Credit(ITC) is admissible on GST charged by service provider on hiring of bus/motor vehicle having approved seating capacity of more than 13 persons for transportation of employees to and from the workplace;
- If ITC is available, whether it would be restricted to the extent of cost borne by the Taxpayer.

Contention by the Taxpayer

- The Taxpayer established that their factory runs on 24-hours basis in 4 shift, also located in remote area, provided transportation facilities to employees in non-air-conditioned bus having approved seating capacity of more than 13 passengers and a nominal recovery is made every month;
- The service providers collect 5% GST on the vehicle hiring charges;
- The difference between the hire/rental charges paid to service providers and the nominal recovery made from the employees is part of the cost to the Taxpayer.

Observations and ruling by AAR

- As per Section 17(5) of CGST Act notwithstanding anything contained in Section 16(1) of CGST Act and Section 18(1) of CGST Act, ITC shall not be available in respect of motor vehicles;
- Motor vehicles for transportation of persons having approved seating capacity of not more than thirteen persons (including the driver), except when they are used for making the following taxable supplies:
  - Further supply of such motor vehicles; or
  - Transportation of passengers; or
  - Imparting training on driving such motor vehicles; or
  - services of general insurance, servicing, repair & maintenance in so far as they relate to motor vehicles.
- Section 17(1) of CGST Act provides that where the goods or services or both are utilized by the registered person partially for the purpose of any business and partially for other purposes, the amount of credit shall be restricted to so much of the ITC as is attributable to the purposes of his business;
- The Taxpayer is eligible to avail the ITC of GST charged by the service provider subject to fulfilment of conditions prescribed in Section 16 of the CGST Act, 2017;
- The Taxpayer is eligible to avail ITC only to the extent of the cost of transportation borne by the Taxpayer.

[AAR-Kerala, M/s. Malabar Cements Limited, Ruling no:KER/128/2021 dated 18 February 2022]

CESTAT RULING

Levy of IGST under Customs Tariff Act, 1975 does not confer any power to question duty levied on BoE by the 'proper officer', invoking power of assessment/ recovery under Customs Act, 1962

Facts of the case

- M/s. Ortho Clinical Diagnostics India P Ltd ('Taxpayer') is engaged in the business of medical equipment manufacture. The issue in the instant case is related to classification of the goods, viz, 'diagnostic kits',

TAX UPDATES
Indirect Tax

'diagnostic reagents on backing', 'controls and calibrators' and 'other consumable reagents' ("impugned goods") corresponding to tariff item 3822 0019 of the first schedule to CTA;

- The Taxpayer approached the CESTAT challenging the assessment order wherein the impugned goods classification of tariff item 3822 0090 of first schedule to CTA was made based on notification no:01/2017-IGST(R);
- It was held that goods which are not specified in schedule I, II, IV, V or VI corresponding to entry no:453 in schedule III of the notification no:01/2017-IGST(R) dated 28 June 2017 is more appropriate.

Contention of the Taxpayer

- Reliance was placed on various technical aspects of the descriptions corresponding to the respective and rival entries in the schedules of the impugned notification;
- Notification no:1/2017-IGST(R) dated 28 June 2017 ("rate notification") prescribes the rates at which 'integrated tax' is to be levied on 'inter-state supply of goods';
- It was further pointed out that the same rules for interpretation, and including several notes, are, in accordance with explanation (iii) and explanation (iv) of the rate notification, to be applied for interpretation;
- Taxpayer submitted that the two types of diagnostic kits are imported by the Taxpayer, finding specific mention at entry no:154 ('enzyme linked immune absorbent assay (ELISA) kits') and entry no:178 (CLIA diagnostic kits) of list 1 referenced with 'diagnostic test kits', classifiable in chapter 30 or any other in the first schedule to CTA, corresponding to entry no:180 of schedule I of the rate notification, are chargeable to tax @5%;
- It was further submitted that 'all diagnostic kits and reagents' of heading 3822 of first schedule to CTA, at entry no:180 of schedule II of the rate notification, as the appropriate description of the other impugned goods to be levied to 'Integrated tax' @12%;
- The Taxpayer argued that the adjudicating authority erred in appropriating the qualifying expression 'diagnostic' to 'reagents' without the support of any acceptable rule or even logic. It was averred that the intent of covering all reagents within this description is evidenced by the recommendation of the GST Council;
- The descriptions are grouped in schedules pertaining to the six rates in vogue corresponding to 'tariff item', 'sub-heading', 'heading' or 'chapter' that have the same meaning as assigned in first schedule to CTA;
- The adjudicating authority erred in appropriating the qualifying expression 'diagnostic' to 'reagents' without the support of any acceptable rule or even logic;
- The Taxpayer relied on the decisions of the Advance Ruling Authority for GST as well as of Commissioner of Customs, Benguluru, preclude scope for resort to contrary view taken in the impugned order as held by the Hon'ble Supreme Court in Damodar J Malpani v. Collector of Central Excise [2002 (9) TMI-144 SUPREME COURT];
- The notification constitutes the tariff comprising of schedules that are mutually exclusive and incorporating a residuary entry for the almost highest rate of duty where the adjudicating authority placed the impugned goods to their detriment.

Contention by the Tax Authority

Tax authority argued at length on the merits of the description as adopted by the adjudicating authority. The inseparability of the qualifying expression from any or either of the succeeding expressions. Further, legislative intent should be ascertained from non-deployment of the term 'all' in the description corresponding to the enumeration adopted by the Taxpayer in the BoE.

Observations and Ruling by the CESTAT

- The scheme of CTA imposes 'integrated tax' on imported goods which is the arithmetical addition of duties of customs to value for assessment of imported goods and posing no discretionary authority therein. This being a distinct tax and not an additional duty of customs equal to another duty charged and collected, the adoption of rate claimed by an importer can be disputed only by such officers who are conferred with authority to do so. Such officers to intrude into self-assessment are Central Tax officers. Hence, assessment was framed in excess of jurisdiction;
- Instead of deliberating on the validity and appropriateness of a tariff item in the first schedule to CTA other than that claimed in the BoE after due notice to the importer, the adjudicating authority adopted a process of elimination of the enumeration of descriptions in the schedules to the rate notification, and ignoring the scheme of its presentation, with the erroneous assumption of jurisdiction to place goods within the ambit of the residuary entry in schedule III of the 'integrated tax' rate notification;
- As there being no prejudice to interests of revenue, the declared classification of the imported goods prevails. The charge of misdeclaration of goods does not sustain and hence confiscation and penalty are also set aside.

[CESTAT-Mumbai-M/s. Ortho Clinical Diagnostics India Pvt Ltd Vs. Commissioner Of Customs (Import), Ruling dated 12 August 2022]

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