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TABLE OF CONTENTS

Accounting Updates 01

Regulatory Updates 07

Tax Updates

- Direct Tax 12
- Transfer Pricing 16
- Indirect Tax 17

ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA ("ICAI")

EAC Opinion – Accounting treatment in the Company's standalone financial statements for the Corporate Guarantee (Deed of Guarantee) issued by the Company being Parent Company to banks/suppliers/service providers on behalf of its Step-down subsidiary company

Facts of the case

A Company was incorporated for procuring, transmission, processing and marketing of natural gas. The Government of India holds 51.45% equity of the Company at present.

The Company has prepared its accounts as per Indian Accounting Standards (Ind ASs) w.e.f. 1st April 2016.

The Company has the following wholly owned subsidiary companies in USA:

- Subsidiary 1, which is a wholly owned subsidiary of the Company and is engaged in the E&P business.
- Step-down subsidiary, which is a wholly owned subsidiary of Subsidiary 1 and a Step-down subsidiary of the Company, and is engaged in LNG trading business.

At present, the Company has issued corporate guarantees on behalf of its US subsidiary, Subsidiary 1 and Step-down subsidiary to the tune of USD 1057.57 million (Rs. 7,810.15 crore). The Guarantee of USD 72.5 million (Rs. 535.41 crore) issued on behalf of Subsidiary 1 is towards meeting obligation of Subsidiary 1 and therefore, guarantee fee is being charged by the Company from Subsidiary 1 and as per the Company's assessment, presently there is no possibility of default by Subsidiary 1. Further, guarantees issued on behalf of Step-down subsidiary of USD 985.07 million (Rs. 7,274.73 crore), have been issued for furtherance of business of the company wherein ultimate beneficiary of these guarantees is the Company itself. As per the Company's assessment, there is no possibility of default by the Step-down subsidiary for meeting its obligation.

Accordingly, the Company of the view that fair value of the guarantees is 'Nil' as the entire transaction is for the furtherance of business of the Company.

Facts of Step-down subsidiary and corporate guarantees provided on behalf of Step-down subsidiary are given hereunder:

Step-down subsidiary, a wholly owned subsidiary of Subsidiary 1, was established on March 28, 2013. On April 01, 2013, Step-down subsidiary executed a terminal service agreement (TSA) with M/s ABC, LP to book capacity rights of approximately 330,000 dekatherm per day (Dth/day) at the Dominion Cove Point LNG liquefaction terminal (A dekatherm (dth) is a unit of energy used primarily to measure natural gas.).

On December 12, 2014, Step-down subsidiary executed a pipeline service agreement (PSA) with M/s ABC, LP to secure pipeline transportation capacity rights of 430,000 Dth/day, in accordance with the broad terms and conditions of the pipeline precedent agreement (PPA) that Step-down subsidiary executed with M/s ABC, LP on April 1, 2013.

On November 30, 2014, Step-down subsidiary signed a gas sale and purchase agreement (GSPA) with M/s XYZ, Inc for sourcing of natural gas on a delivered basis at the inlet of the pipeline at the Dominion Cove Point LNG liquefaction terminal for a term of 20 years. The natural gas purchased from M/s XYZ Inc will be liquefied at the Dominion Cove Point LNG liquefaction Terminal.

During September 2017, the Company and Stepdown subsidiary have entered into a LNG Sale & Purchase Agreement (SPA), wherein Step-down subsidiary is to sell the entire quantity of LNG to the Company on back-to-back basis on FOB US Coast basis for the entire contract period of 20 years. The entire risks and obligations of Step-down subsidiary under the upstream contracts

Date of Issue	Valid Up to	Company (To whom Guarantee Given)	Fund Based (FB) Amount In USD	Non-Fund Based (NFB) Amount In USD	Fund Based (FB) Amount In Rs. -Crs.	Non-Fund Based (NFB) Amount In Rs. -Crs.	Purpose of Guarantee
01.04.2013	31.12.2039	M/s ABC LP	0	$ 700 Mn	0	5169.50	Payment Security under TSA
01.04.2013	31.12.2039	M/s ABC LP	0	$ 90 Mn	0	664.65	Payment Security under PPA
29.12.2014	28.12.2044	M/s XYZ	0	$ 25Mn	0	184.63	Performance Guarantee for GSPA
24.04.2020	23.04.2021	State Bank of India, New York Branch	$70 Mn	0	516.95	0	*Working Capital Facility
28.09.2020	27.09.2021	Credit Agricole Corporate and Investment Bank	0	$100.06 Mn	0	739.01	*SBLC Facility

** These Working Capital Facility and Stand-by Letter of Credit Facility (SBLC) are being remewed from same bank or another bank (based on the Competitive rates) on yearly basis for next one year (12 months)*

ACCOUNTING UPDATES

entered by Step-down subsidiary with its suppliers have been passed to the Company through the SPA. The Company will take delivery of and pay for specified quantities of LNG procured by Step-down subsidiary, or compensate Step-down subsidiary for its costs incurred in the event that the Company fails to take delivery of the specified quantities (i.e., take or pay). Step-down subsidiary bears limited risk and is acting as a low margin distributor and managing the operations of the contracts only. Further, under Transfer Pricing Regulation, the Company has also filed Advance Pricing Agreement, and presently, Step-down subsidiary is charging 10% of value-added expenses as margin in overall value chain from the Company.

Under the LNG SPA, the Company is purchasing entire quantity of LNG from Step-down subsidiary and Step-down subsidiary is being reimbursed for (i) the cost of natural gas plus liquefaction expenses and other third-party costs; and (ii) all other expenses plus a mark-up.

In order to carry out the operations smoothly, as per contract terms, the Company has given the corporate guarantees on behalf of Stepdown subsidiary.

The company has stated that the performance of Step-down subsidiary under the contracts signed by it with its supplies are solely dependent upon the performance of the Company and the failure of payment to third parties (i.e. suppliers of Stepdown subsidiary) is solely within the control of the Company. Therefore, the expected credit loss due to this guarantee is 'Nil'. Further due to the same reason, the Company is not charging any guarantee fee from the Step-down subsidiary for providing these guarantees. Charge for provision of guarantee would be appropriate where the issue of guarantee is considered to be a service performed by the issuer for the benefit of the entity availing the guarantee. However, in cases where the guarantee is for the benefit of the guarantor only, i.e., for promoting/ protecting its interest, no charge/ compensation for issue of guarantee is warranted.

Further, the Company is accounting for the amount payable for gas purchase from Stepdown subsidiary in its books of account and if the Company provides loss allowance for guarantee given on behalf of Step-down subsidiary for the same transaction, it amounts to duplication and overstating the Company's liabilities.

It may also be noted that the parent companies of the counter parties of TSA & PPA have also provided reciprocal Corporate Guarantee to Stepdown subsidiary for the performance of M/s ABC LP (Operator) and M/s XYZ Inc.

It is quite clear that the parent company is required to provide corporate guarantee on behalf of its subsidiaries as newly formed subsidiaries do not have the requisite financial standing, credit worthiness and credit rating. However, these corporate guarantees could have been avoided, if the contracts would have been entered by the Parent Companies.

The company has also emphasised that all the guarantees provided by the Company on behalf of Step-down subsidiary are in furtherance of the Company's business, wherein the Company is the ultimate beneficiary for these guarantees provided by the Company. Further, entire performance of Step-down subsidiary is also dependent upon the performance of the Company. So, it can be construed that the Company has provided these guarantees for its own performance only.

Step-down subsidiary started its commercial operations in the year 2018. Since starting, Step-down subsidiary is having a back to back arrangement with the Company and the Company has lifted all its LNG cargos from the Step-down subsidiary on FOB US Coast basis. Some of these cargos are directly imported to India and some are sold in the international market by the Company. Further, if the Company charges guarantee fees to Step-down subsidiary, the same will be loaded in the gas cost along with the margin by Step-down subsidiary to the Company.

Till date, in this contract, there is no default on the part of Step-down subsidiary and the Company with respect to their contractual obligations, and hence, the corporate guarantees given by the company on behalf of Step-down subsidiary carry no risk. Further, in India, gas market is growing and the Government of India is also promoting use of LNG / R-LNG. The Company has laid additional pipeline network with approx. pipeline length of 2655 Km. Along the pipeline, approximately four fertilizer plants will get revived, and as a result, the LNG requirement in India will increase. Presently, natural gas share in the India energy basket is around 6% and the Government of India has set a target to increase the same to 15%. Therefore, it is expected that usage of natural gas in

Date of Issue	Valid Up to	Company (To whom Guarantee Given)	Guarantee Amount In USD	Non-Fund based (NFB) Amount In Rs. Crs.	Purpose of Guarantee
01.04.2013	31.12.2039	Step-down Subsidiary	$1750 Mn	12923.75	Payment Security under TSA
01.04.2013	31.12.2039	Step-down Subsidiary	$150 Mn	1107.75	Payment Security under PPA
29.12.2014	31.12.2039	Step-down Subsidiary	$25 Mn	184.63	Performance Guarantee for GSPA

ACCOUNTING UPDATES

India will rise and due to limited domestic production of the gas, the same shall be met through imported LNG.

Currently, the Company is disclosing the above guarantees in Notes to Accounts under details of Loans, Investment, Guarantees and security given by the Company under the Companies Act, 2013 and under Financial Risk Management (Liquidity Risk), as per the requirements of Ind AS 107, 'Financial Instruments: Disclosures'

Query

In view of the above, the company is hereby seeking opinion from the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India on the following issues:

- As per Ind AS, whether any accounting treatment is required for the corporate guarantees provided on behalf of Step-down subsidiary for satisfaction of its obligations under the contract (i.e., TSA, PPA and GSPA), towards the suppliers (i.e., M/s ABC LP and M/s XYZ Inc) considering back to back contract with the Company for procuring 100% LNG from Step-down subsidiary and that there is no credit risk involved for Stepdown subsidiary as 100% risk is transferred to the Company through SPA.
- As per Ind ASs, whether any accounting treatment is required for the corporate guarantees provided on behalf of Step-down subsidiary, for obtaining working capital loan and SBLC facility from bankers, as the same have been availed by Step-down subsidiary to meet the temporary obligations to the suppliers, due to time lag between payment made by the Company to Step-down subsidiary and payment made by Step-down subsidiary to its suppliers.
- Whether any expected credit loss is to be provided for any of the above guarantees as per Ind AS 109, 'Financial Instruments'.
- Whether any other disclosure is required for any of the above guarantees in the Company's books of account, as presently, the Company is disclosing these guarantees under Notes to Accounts.
- Any other advice in the context, which EAC may deem fit.

Points considered by the Committee

The Committee notes that the basic issue raised by the company relates to the accounting treatment of the bank guarantees provided by the Company on behalf of its Step-down subsidiary in the separate financial statements of the Company. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case. The Committee has only examined the issue from Ind AS perspective and has not examined the regulatory or legal classification and implications, including those arising under Income-tax Act and Foreign Exchange Management Act (FEMA). The Committee presumes that the Step-down subsidiary is not acting as an agent of the Company. The Committee also observes from the Company's financial statements that the Company has neither previously nor on transition to Ind ASs in the financial year 2016-17, asserted explicitly that it regards financial guarantee contracts as insurance contracts and uses accounting that it is applicable to insurance contracts. Consequently, the irrevocable option to treat the corporate guarantee as an insurance contract available under paragraph 2.1(e) of Ind AS 109 is not applicable. The Committee also wishes to point out that the accounting standards referred hereinafter are Indian Accounting Standards (Ind ASs), notified under the Indian (Accounting Standards) Rules, 2015.

The Committee notes that Appendix A to Ind AS 109 defines a financial guarantee contract as follows:
"**financial guarantee contract** A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument."

Further, paragraphs B2.5 of Appendix B to Ind AS 109 and AG 8 of Appendix A to Ind AS 32, 'Financial Instruments: Presentation' provide as follows:

Ind AS 109

"B2.5 Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2.1(e)):

- Although a financial guarantee contract meets the definition of an insurance contract in Ind AS 104 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or Ind AS 104 to such financial guarantee contracts. If this Standard applies, paragraph 5.1.1 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a standalone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through profit or loss or unless paragraphs 3.2.15–3.2.23 and B3.2.12–B3.2.17 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:
  - the amount determined in accordance with Section 5.5; and
  - the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115 [see paragraph 4.2.1(c)]. (b) …"

ACCOUNTING UPDATES

Ind AS 32

"AG8 The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognised in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of Ind AS 104."

The Committee notes that a financial guarantee contract is defined under Ind AS 109 as a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument. For a financial guarantee under Ind AS 109 to exist, amongst others, there shall be a reimbursement for loss incurred by a specified debtor.

In the extant case, the Committee notes the following:

- The Company has undertaken to irrevocably and unconditionally guarantee M/s ABC LP, prompt payment by the Step-down subsidiary of all the amounts that become due and payable by the Step-down subsidiary under the Terminal Service Agreement, up to amount stated in the respective agreements. In case of default in payment of guaranteed obligation by the Step-down subsidiary, the Company shall promptly pay M/s ABC LP.
- The Company has undertaken to irrevocably and unconditionally guarantee M/s XYZ Inc, prompt payment by the Stepdown subsidiary of all the amounts that become due and payable by the Step-down subsidiary, up to $ 25 million. In case of default in payment of guaranteed obligation by the Step-down subsidiary, the Company shall promptly pay M/s XYZ Inc.
- The Company has undertaken to irrevocably and unconditionally guarantee State Bank of India, New York branch, due repayment of all amounts outstanding under credit facilities due and payable by the Step-down subsidiary to the extent of $ 70 million in the event of failure on the part of the Step-down subsidiary to repay the amount drawn under credit facilities.
- The Company has undertaken to irrevocably and unconditionally guarantee Credit Agricole, due repayment of all amounts outstanding under credit facilities due and payable by the Stepdown subsidiary to the extent of $ 100 million in the event of failure on the part of the Step-down subsidiary to repay the amount drawn under credit facilities.

The Committee notes that the term 'debt instrument' is neither defined in Ind AS 109 nor in Ind AS 32. The Committee is of the view that the term implies a contractual right to receive cash arising on account of a debtor-creditor or lender- borrower relationship. The Committee is of the view that apparently there is debtor-creditor or lender-borrower relationship between the Stepdown subsidiary and the holder/ beneficiary of the guarantee contract (viz., M/s ABC LP, M/s XYZ Inc, SBI etc.) under the terms of TSA/PPA/ GSPA/credit facilities etc. In case the Step-down subsidiary does not make payment to the holder/ beneficiary of the guarantee (viz., M/s ABC LP, M/s XYZ Inc, SBI etc.) under TSA/PPA/GSPA or credit facilities, the holder has a right to recoup the loss suffered by it from the Company. The Committee is, therefore, of the view that the corporate guarantee issued by the Company to the various parties mentioned above meets the definition of financial guarantee contract given in Ind AS 109. The Committee is also of the view that there exists a contractual right of the holder of the guarantee contract, to receive cash from the guarantor (viz., the Company) and a corresponding contractual obligation of the guarantor to pay the holder, if the Step-down subsidiary defaults. This is so even if the holder's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on future act of default on future payments becoming due and payable by the Step-down subsidiary. Therefore, the contingent right and obligation meet the definition of financial guarantee contract, in accordance with the requirements of paragraph AG 8 of Ind AS 32.

The Committee further notes that the company has argued that the performance of Step-down subsidiary under the contracts signed by it with its suppliers are solely dependent upon the performance of the Company and the failure of payment to third parties (i.e. suppliers of Stepdown subsidiary) are solely within the control of the Company. Therefore, the expected credit loss due to this guarantee is 'Nil'. Further due to the same reason, the Company is not charging any guarantee fee from Step-down subsidiary for providing these guarantees. Charge for provision of guarantee would be appropriate where the issue of guarantee is considered to be a service performed by the issuer for the benefit of the entity availing the guarantee. However, in cases where the guarantee is for the benefit of the guarantor only, i.e., for promoting/ protecting its interest, no charge/compensation for issue of guarantee is warranted.

The Committee also notes that the company has also put forth an argument that the Company is accounting for amount payable for gas purchase from Step-down subsidiary in its books of account and if the Company provides loss allowance for guarantee given on behalf of Step-down subsidiary for the same

ACCOUNTING UPDATES

transaction, it amounts to duplication and overstating the Company's liabilities.

The Committee notes that the trade payable for the gas purchased from the Step-down subsidiary and the financial guarantee issued by the Company to third party on behalf of the Step-down subsidiary are separate financial liabilities emanating from separate transactions. The Company has obligations towards different parties in the two transactions. Therefore, the Committee is of the view that recognising the two financial liabilities and providing for loss allowance on the financial guarantee contract shall not result in duplication or overstating of liabilities. Further, as also pointed out by the company, since there could be time lag in the payment made by the Company to Step-down subsidiary and payment made by the Step-down subsidiary to its suppliers, it may result in expected credit losses at the reporting date for some time till the payment becomes due from the Parent company from the perspective of the Step-down subsidiary (refer paragraph B 5.5.28 of Ind AS 109).

The Committee further notes that another argument put forth by the company is that these guarantees could have been avoided, if the contracts would have been entered by the Company itself. All the guarantees provided by the Company on behalf of Step-down subsidiary are in furtherance of the Company's business, wherein the Company is the ultimate beneficiary for these guarantees provided by the Company. Further, entire performance of Step-down subsidiary is also dependent upon the performance of the Company. So, it can be construed that the Company has provided these guarantees for its own performance only.

The Committee believes that the financial guarantee provided to an external party on behalf of a subsidiary is required to be accounted for in the separate financial statements of the parent company as per Ind AS 109. This is notwithstanding the fact that the Stepdown subsidiary's financial performance and position may be dependent on the business that is generated with the Company and that the Company being the ultimate parent of the subsidiary, is ultimately the beneficiary of the subsidiary's operation. From the perspective of the separate financial statements, the reporting entity is the parent company only and not the group, i.e., parent company together with the subsidiaries. Therefore, it does not matter if the financial performance of the Step-down subsidiary is dependent on its business operations with the Company.

Further, the company has also argued that till date there is no default on the part of Step-down subsidiary and the Company w.r.t. their contractual obligations, hence the corporate guarantees carry no risk. The Committee is of the view that the extent of credit risk shall not affect the initial recognition of the financial guarantee liabilities. However, this may be one of the factors that the Company may consider for the purpose of fair valuation at the time of initial measurement and for measuring the expected credit loss at the time of subsequent measurement.

Further, with regard to accounting treatment of such financial guarantee, the Committee is of the view that the guarantee obligations, as mentioned above, should be recognised and measured as per the requirements of Ind AS 109 by the Company in its separate financial statements. In this regard, the Committee notes from paragraph B 2.5(a) of Ind AS 109 reproduced above and other requirements of Ind AS 109 (paragraphs 5.1.1, 5.1.1A and B5.1.1) that the issuer of a financial guarantee should recognise it initially at its fair value. The Committee is of the view that this requirement is also applicable in respect of a guarantee issued by a parent on behalf of its subsidiary and where no fee or commission is charged by the parent for issuance of such guarantee. Accordingly, in the extant case, the Company, in its separate financial statements, should initially recognize a liability (a deferred income such as 'unearned financial guarantee commission') at fair value which will be equivalent to an amount that the Step-down subsidiary would have paid to obtain a similar guarantee in a standalone arm's length transaction.

The Committee further notes that in the extant case, the guarantee obligation has been undertaken by the Company in its capacity as the ultimate parent of the Step-down subsidiary company. The Company has a right to future economic benefits arising from its overall investments in the Step-down subsidiary through its control over Subsidiary 1. In case the Company is not charging any guarantee commission or other consideration to the Step-down subsidiary company, upon initial recognition of the financial guarantee liability, the Company should recognize deemed investment in the Subsidiary 1 and the same should be accounted for as per the requirements of Ind AS 27.

The Committee also notes the requirements of Ind AS 109 in respect of subsequent measurement of financial guarantee as follows:

"4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:

- financial liabilities at fair value through profit or loss. Such liabilities, including derivatives that are liabilities, shall be subsequently measured at fair value.
- financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 3.2.15 and 3.2.17 apply to the measurement of such financial liabilities.
- financial guarantee contracts. After initial recognition, an issuer of such a contract shall (unless paragraph 4.2.1(a) or (b) applies)

ACCOUNTING UPDATES

subsequently measure it at the higher of:

- the amount of the loss allowance determined in accordance with Section 5.5 and
- the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115. …"

5.5.1 An entity shall recognise a loss allowance for expected credit losses on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a contract asset or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d).

B5.5.32 For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee.

5.7.9 Despite the requirements in paragraphs 5.7.7 and 5.7.8, an entity shall present in profit or loss all gains and losses on loan commitments and financial guarantee contracts that are designated as at fair value through profit or loss. From the above, the Committee notes that as per the requirements of Ind AS 109, expected credit loss should be considered on financial guarantee contracts at the time of subsequent measurement.

The Committee notes that Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' states as follows:

"2 This Standard does not apply to financial instruments (including guarantees) that are within the scope of Ind AS 109, Financial Instruments."

Therefore, financial guarantees, in the extant case, being governed by Ind AS 109, are not within the scope of Ind AS 37 and therefore, can not be classified as contingent liabilities. Instead, the Company should comply with the relevant presentation and disclosure requirements of Ind AS 107 and related disclosures of Division II of Schedule III to the Companies Act, 2013 for financial liability.

Opinion

On the basis of the above, the Committee is of the following opinion on the issues raised above:

(i) and (ii) The Company should account for the financial guarantee contracts as per the requirements of Ind AS 109, as discussed above.

(iii) The Company should account for expected credit loss provision, if any, as per the requirements of Ind AS 109, as discussed above.

(iv) The disclosures in the Company's financial statements should be provided based on the classification as financial liabilities, as discussed above. The Company should comply with the relevant presentation and disclosure requirements of Ind AS 107 and Division II of Schedule III to the Companies Act, 2013.

(v) Refer above

REGULATORY UPDATES

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Securities And Exchange Board Of India (Mutual Funds) (Amendment) Regulations, 2022

The SEBI has issued a notification dated January 25, 2022, to further amend the Securities and Exchange Board Of India (Mutual Funds) (Amendment) Regulations, 1996.

Few key amendments are highlighted below:

- Regulation 39 (3) which deals winding up of mutual fund schemes, now require that trustees shall give notice within one day, disclosing the circumstances leading to the winding up of the scheme-
  - to the Board; and
  - in two daily newspapers having circulation all over India, a vernacular newspaper circulating at the place where the mutual fund is formed:

  Further, where a scheme is to be wound up under clause (a) of sub-regulation (2), the trustees shall obtain consent of the unit holders participating in the voting by simple majority on the basis of one vote per unit and publish the results of voting within forty five days from the publication of notice under sub-regulation (3):

  In case the trustees fail to obtain the required consent of the unitholders under clause (a) of sub-regulation (2), the schemes shall be reopened for business activities from the second business day after publication of results of the voting.

  2. As per regulation 50 which specify “To maintain proper books of account and records, etc.” the sub-regulation (1A) has been inserted which now require that the financial statements and accounts of the mutual fund schemes shall be prepared in accordance with Indian Accounting Standards (IND AS) and any addendum thereto, as notified by the Companies (Indian Accounting Standards) Rules, 2015, as amended from time to time.

  Further, it also provided that in case there is any conflict between the requirements of IND AS and these regulations and guidelines issued thereunder, the asset management companies shall follow the requirements specified under these regulations.

Circular dated 3rd January 2022: Scheme of Arrangement by Listed Entities - Clarification w.r.t. timing of submission of No Objection Certificate (“NOC”) from the lending scheduled commercial banks/ financial institutions/ debenture trustee

SEBI vide its previous circulars dated 16th November 2021 and 18th November 2021, amended certain provisions relating to the Schemes of Arrangement by listed entities, as laid down under SEBI Master Circular which were immediately made applicable for all the schemes filed with the stock exchanges. One of the amended provisions require listed entities to submit NOC from the lending

scheduled commercial banks / financial institutions / debenture trustees to the stock exchanges.

SEBI, vide its latest circular dated 3rd January 2022, clarified that such NOC must be submitted before the receipt of the No-objection letter from stock exchange in terms of Regulation 37(1) of the SEBI (Listing Obligations and Disclosure Requirements) (“LODR”) Regulations, 2015.

Circular dated 7th January 2022: Disclosure obligations of listed entities in relation to Related Party Transactions (“RPTs”)

SEBI, vide its previous circular dated 22nd November 2021, specified the following disclosure obligations of listed entities in relation to RPTs with respect to specified securities:

- Information to be provided to the Audit Committee for their approval and the shareholders for their consideration.
- Format for reporting of RPTs to stock exchange.

Vide this circular and with immediate effect, SEBI has made the above disclosure obligations applicable to High Value Debt Listed Entities as well.

Notification dated 14th January 2022: Amendment to SEBI (Foreign Portfolio Investors) Regulations, 2019 (“FPI Regulations”)

Apart from the exemption already granted from strict enforcement of provisions of FPI Regulations in special cases, SEBI, vide this notification, has granted exemption in other cases as well if it decides suo motu or upon FPI making application requesting such exemption.

The notification clarifies that application must quote valid reasons for availing exemption along with a non-refundable fee of USD 1,000 and such a relaxation shall be granted by SEBI only upon satisfaction that the non-compliance is due to factors beyond the entity’s control, or the requirement is procedural or technical in nature.

REGULATORY UPDATES

Notification dated 14th January 2022: SEBI (Issue of Capital and Disclosure Requirements) (Amendment) Regulations, 2022 ("Amended ICDR Regulations")

The key takeaways of the Amended ICDR Regulations are as follows:

- When any money is raised by issuer company where the offer document sets out an object, but acquisition or investment target has not been identified, the amount raised for General Corporate purposes and for such objects together shall not exceed 35% of the total amount being raised. Further, of this 35%, the amount particularly raised for such objects where the acquisition or investment target has not been identified shall not exceed 25%.

  The above general condition is applicable in all cases like IPOs, FPOs, rights issue of securities.
- One of the eligibility requirements for Initial Public offer ("IPO") is that in case of non-fulfilment of certain specified conditions, an issuer shall be eligible to make IPO only through a book building process with at least 75% allotment to be made to Qualified Institutional Buyers ("QIBs"). For such cases, new Regulation 8A has been inserted providing additional conditions to be fulfilled which are as under:
  - Shares offered for sale by selling shareholders holding more than 20% of the pre-issue shareholding of the issuer company, shall not exceed more than 50% of their pre-issue shareholding.
  - Shares offered for sale by selling shareholders holding less than 20% of the pre-issue shareholding of the issuer company, shall not exceed more than 10% of their pre-issue shareholding.
- In case of IPOs and Further Public Offer ("FPO"), while the maximum cap on a price band is set at 120% of the floor price, a new proviso has been inserted mandating minimum cap on price band at 105% of the floor price.
- Allocation to non-institutional investors category in an IPO and FPO issue through a book building process shall be as follows:
  - 1/3rd of the portion available to non-institutional investors shall be reserved for applicants with application size of more than INR 2 Lacs maximum up to INR 10 Lacs.
  - 2/3rd of the portion available to non-institutional investors shall be reserved for applicants with application size of more than INR 10 Lacs.
  - Unsubscribed portion in the above sub-categories may be allocated to applicants in the other sub-category of non-institutional investors.
- In the event of non-receipt of minimum subscription, all application monies received shall be refunded to the applicants within 4 days from the closure of the issue.
- In case of IPOs, if the issuer fails to obtain listing or trading permission from the stock exchanges, it shall refund the entire monies received within 4 days of receipt of such intimation from stock exchanges. If any such money is not repaid within 4 days, the issuer and every director of the company who is an officer in default shall, on and from the expiry of the fourth day, be jointly and severally liable to repay that money with interest at the rate of 15% per annum.
- The Credit Rating Agency registered with SEBI is permitted to act as Monitoring Agency instead of Scheduled Commercial Banks and Public Financial Institutions. The monitoring agency shall submit its report on a quarterly basis till entire proceeds of the issue have been utilized.
- In case of rights issue through fast-track route, the issuer / promoter / promoter group / director of the issuer having settled any alleged violation of securities law through settlement mechanism in past 3 years are now eligible to make such issue after having disclosed the settlement order in offer letter.
- In case of FPO, the eligibility requirements are now revised to state that the issuer is eligible to make FPO if it has not changed its name in the last 1 year immediately preceding the date of relevant offer document with an exception that in case of any name change in past 1 year, at least 50% of the revenue should have been generated in the new name. Further, if issuer fails to fulfil this condition, it shall make FPO only through book building process and allot at least 75% to QIBs.
- An issuer shall not be eligible to make a preferential issue if it has any outstanding dues to SEBI, the stock exchanges or the depositories, except where such dues are the subject matter of a pending appeal or proceeding(s) admitted by the relevant Court, Tribunal or Authority.
- A new condition to be fulfilled by a listed issuer making preferential issue of specified securities is added which requires the issuer to make an application seeking in-principal approval to the stock exchange(s), where its equity shares are listed, on the same day when the notice has been sent in respect of the shareholders' general meeting.
- Any preferential issue that results in more than 50% change in post diluted paid-up capital of the issuer, shall require a valuation report from independent registered valuer.
- In case of preferential issue, specified securities except Super Rights equity shares held by the promoters and locked-in under the provisions of these regulations, may be pledged as collateral for a loan to be granted by the institutions specified under Amended ICDR Regulations. After the pledge is invoked, the lock-in on the specified securities shall continue and such security shall become non-transferable till expiry of the lock-in period.

Notification dated 24th January 2022: SEBI (Alternative Investment Funds) ("AIFs") Amendment Regulations, 2022 ("Amended AIF Regulations")

Vide this notification, SEBI has inserted a new -Chapter III-B in relation to 'Special Situation Funds' ("SSFs") providing a

REGULATORY UPDATES

regulatory framework for funds investing in Special Situation Assets.

The Amended AIF Regulations (with some exceptions) shall be applicable to the SSFs, the schemes of SSFs and their sponsors and managers, key features of which are as follows:

- "Special Situation Fund" is defined to mean a Category 1 AIF that invests in special situation assets in accordance with its investment objectives and may act as a resolution applicant under the Insolvency and Bankruptcy Code, 2016 ("IBC, 2016")
- "Special Situation Asset" is defined to mean:
  - stressed loan available for acquisition or as part of a resolution plan approved under the IBC 2016 or in terms of any other policy of the RBI or Government of India issued in this regard from time to time;
  - security receipts issued by an Asset Reconstruction Company registered with the RBI;
  - securities of investee companies satisfying the specified conditions as provided in the Amended Regulations;
  - any other asset as may be specified by SEBI from time to time.
- Each scheme of SSF shall have a corpus of such amount and shall accept the investment from investors of such value as specified by SEBI. Further, SSFs shall not accept investments from an AIF which is not SSF.
- SSFs must invest only in Special Situation Asset as defined in the Amended AIF Regulations. However, the SSF shall not invest in its associates, units of an AIF which is not SSF and units of SSF manged or sponsored by its manager/sponsor or associates of its manager/sponsor.
- Any investment by the SSF in stressed loan acquired as per RBI's applicable directions shall be subject to lock in period as may be specified by SEBI.

Notification dated 24th January 2022: SEBI (LODR) (Amendment) Regulations, 2022 ("Amended LODR Regulations")

The key highlights of the Amended LODR Regulations are as follows:

- The shareholders' approval must be taken for appointment of any person as a manager within 3 months from the appointment date or at the next general meeting, whichever is earlier.
- The appointment/re-appointment of previously rejected (by shareholders) managing director or a whole-time director or a manager shall be done only with the prior approval of shareholders. Further, the explanatory statement annexed to notice of shareholder's meeting to obtain such approval must contain a detailed justification by the Nomination and Remuneration Committee and the Board for such person's recommendation.
- A report by the monitoring agency on utilization of proceeds of a public or rights issue, shall now be placed before the Audit Committee on a quarterly basis.
- A listed entity shall issue the share certificates/receipts/advice (whether new or duplicate) in case of subdivision, split, consolidation, renewal, etc. in dematerialized ("demat") form. Even the request for transfer/transmission of securities must be processed in the demat form.

Circular dated 25th January 2022: Issuance of Securities in demat form in case of Investor Service Requests ("ISR")

With an aim to enhance the ease of dealing in securities markets, SEBI mandated the listed companies to issue securities in demat form only while processing the ISR such as issue of duplicate securities certificate, claim from unclaimed suspense account, renewal/exchange of securities certificate, endorsement, sub-division/splitting of securities certificate, consolidation of securities certificates/folios, transmission, transportation.

Further, the circular also provides operational guidelines prescribing the procedure to be followed by the listed entities / Registrars to an Issue and Share Transfer Agents in processing such ISR and issuance of demat securities.

Circular dated 31st January 2022: Change in control of the Asset Management Company ("AMC") involving Scheme of Arrangement under the Companies Act 2013

SEBI, vide its previous circular dated 4th March 2021, prescribed the procedure to be followed for change in control of AMCs. Vide this circular, SEBI has streamlined the procedure for cases where the change in control is pursuant to a Scheme of Arrangement. The circular shall be applicable to all the schemes which are filed with National Company Law Tribunal ("NCLT") on or after 1st March 2022.

The details of this circular are as under:

- The application seeking approval for the change in control of AMC (under the applicable Mutual Fund Regulations) shall be filed with SEBI prior to filing the same with the NCLT.
- SEBI shall grant an in-principle approval upon being satisfied with the compliance of applicable regulatory requirements, validity of which shall be 3 months from the date of issuance within which the relevant application shall be made to the NCLT.
- Within 15 days from the date of order of NCLT, the applicant shall submit the NCLT approved application & its order along with other specified the documents to SEBI for final approval.
- All other provisions prescribed in the circular dated 4th March 2021 regarding the process shall remain unchanged.

MINISTRY OF CORPORATE AFFAIRS ("MCA")

Notification dated 11th January 2021: Commencement date for certain provisions of the Companies (Amendment) Act 2017 and the Companies (Amendment) Act 2020 (collectively referred "Amended Acts")

MCA vide its two notifications dated 11th January 2022 has brought some provisions of the Amended Acts in force with effect from 1st July 2022, details of which are mentioned here under:

REGULATORY UPDATES

Reference of Amended Acts	Provision
Section 80 of Companies (Amendment) Act 2017	▪ Where the document/fact/information pertaining to filing of annual return and financial statements with Registrar of Companies ("ROC") is not submitted, filed, registered, or recorded within the period provided in the relevant section, the same shall be done on payment of minimum additional fees of INR 100 per day or such other fees as prescribed. ▪ Where the document/fact/information in all cases other than cases mentioned above is not submitted, filed, registered, or recorded within the period provided in the relevant section, the same shall be done on payment of prescribed additional fees. ▪ In case of default on two or more occasions in submitting, filing, registering or recording of document/fact/information, the same shall be done on payment of higher fees as prescribed, which shall be at least twice the additional fees provided under point 1 & 2 above.
Section 56 of Companies (Amendment) Act 2020	In case of default on two or more occasions in submitting, filing, registering, or recording of document/fact/information as may be prescribed, the same shall be done on payment of higher additional fees as prescribed.

Notification dated 11th January 2021: Companies (Registration Offices and Fees) Amendment Rules, 2022 ("Amended Rules")

The Amended Rules provides for the revised table of additional fee and higher additional fee (in certain cases) which shall be applicable for delay in filing of forms except forms related to increase in nominal share capital/filing of annual return & financial statements/filing of charge with ROC which shall be effective from 1st July 2022.

Filing Delay period	Additional Fees (multiple of normal fees)	Higher Additional Fees in certain cases (multiple of normal fees)
upto 15 days (Forms u/s 139 and 157)	1 time	-
16-30 days (Forms u/s 139 and 157) and upto 30 days (remaining forms)	2 times	3 times
31-60 days	4 times	6 times
61-90 days	6 times	9 times
91-180 days	10 times	15 times
181 days and above	12 times	18 times

To implement the above higher additional fee structure, corresponding amendments are made in Section 403 of Cos Act vide the Amended Acts.

THE RESERVE BANK OF INDIA (RBI)

Basel III Framework on Liquidity Standards - Liquidity Coverage Ratio (LCR), Liquidity Risk Monitoring Tools and LCR Disclosure Standards and Net Stable Funding ratio - Small Business Customers

The RBI vide circular dated January 06, 2022, has increased the threshold for deposits and other funds of non-financial small businesses by 50 per cent to Rs 7.5 crore for the purpose of maintenance of Liquidity Coverage Ratio (LCR), with the aim to better align its regulations with Basel norms and also enable banks to manage liquidity risks more effectively.

The above modification is also applicable to deposits and other 'extensions of funds' received from small businesses.

This circular is applicable to all Commercial Banks other than Regional Rural Banks, Local Area Banks and Payments Banks.

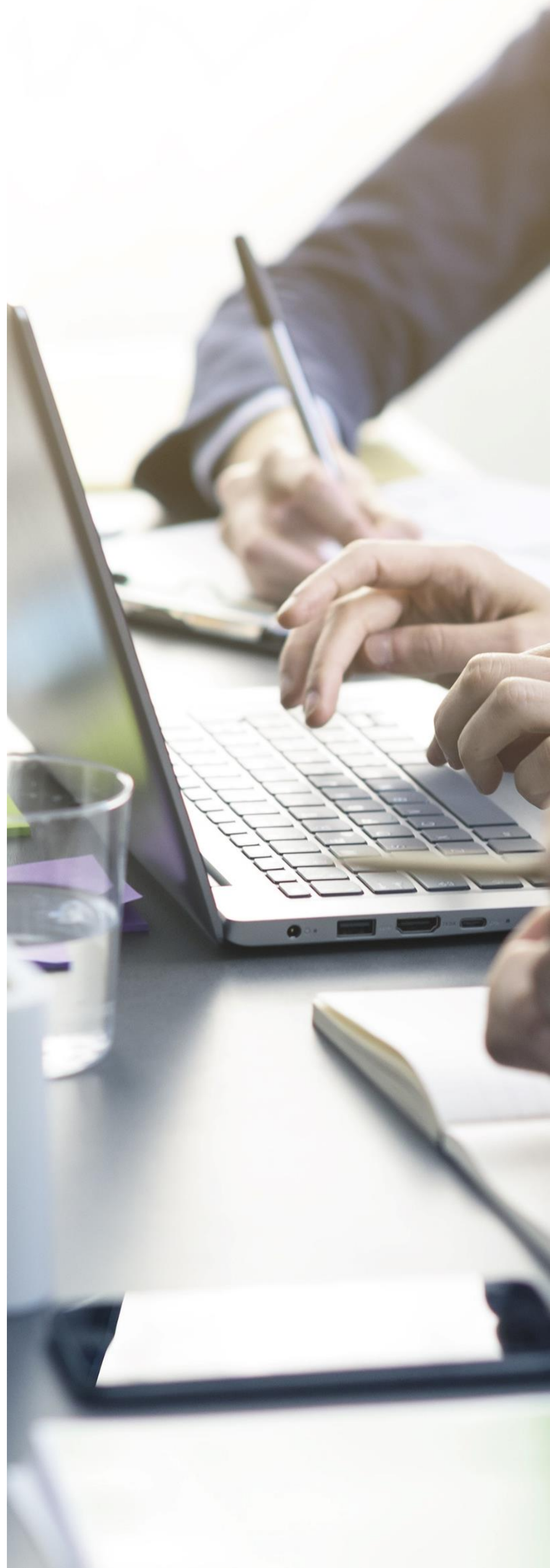
THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

Implementation Guide to Standard on Auditing (SA) 210 Agreeing the Terms of Audit Engagements and on SA 560 Subsequent Events

The ICAI has issued Implementation Guide to Standard on Auditing (SA) 210 Agreeing the Terms of Audit Engagements and on SA 560 Subsequent Events on January 15, 2022.

These Implementation Guides contain frequently asked questions and their responses, templates, checklists, case studies, etc., as appropriate.

REGULATORY UPDATES



Guidance Note Schedule III to The Companies Act, 2013

The ICAI has issued following Guidance Note on Schedule III to The Companies Act, 2013 on January 24, 2022:

- Guidance Note on Division I – Non Ind-As Schedule III to The Companies Act, 2013
- Guidance Note on Division II –Ind AS Schedule III to The Companies Act, 2013
- Guidance Note on Division III - Schedule III to The Companies Act, 2013 For NBFC that is required to comply with Ind AS

MCA revised the format of Schedule III (Division I, II & III) to the Companies Act, 2013 vide notification dated March 24, 2021 by requiring disclosure of Additional Regulatory Information such as disclosure of Title Deeds of Immovable Property that are not in the name of Company, Ageing Schedule of CWIP, Intangible Assets under development, Trade Payables and Trade Receivables, Disclosure of Ratios, Undisclosed Income, CSR, reconciliation of statements filed with banks for the purpose of working capital etc. and various other requirements such as disclosures about promoter shareholding and subsidiaries, mandatory rounding off and re-classification of certain line items etc.

In light of the said amendments, the Corporate Laws & Corporate Governance Committee has issued Guidance Note on Division I, II & III.

TAX UPDATES
Direct Tax

CIRCULARS/ NOTIFICATIONS/PRESS RELEASE

Union Budget 2022

Nearly two years into the pandemic with an arguably, a V-shaped recovery in the economy in the bag, the Hon'ble Finance Minister, Ms. Nirmala Sitharaman, had the unique opportunity to present the annual Budget that is focused on growth and recovery. Unsurprisingly, the Budget has been hailed as progressive, universally by the captains of the industry and business. To read BDO India's analysis of the Budget 2022, please go to : https://www.bdo.in/en-gb/insights/publications/india-union-budget-2022-23_an-overview-a-bdo-india-publication

CBDT notifies e-Advance Ruling Scheme

With a view to fasten the process as well as reduce the pendency of applications before the Authority of Advance Ruling (AAR), the Finance Act, 2021 introduced Board of Advance Ruling (BAR) w.e.f. 1 April 2021. In order to empower the BAR, the CBDT has recently notified the e-Advance Ruling Scheme, 2022. To read our detailed analysis, please go to : https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-notifies-e-advance-ruling-scheme

[Notification No.7/2022, dated 18 January 2022]

CBDT issues guidelines on the availability of exemption in case of high premium ULIPs

The Finance Act, 2021 amended section 10(10D) of the IT Act and inserted new sub-section (1B) to the section 45 of the Act to bring proceeds from high premium Unit Linked Insurance Policy (ULIP) under the purview of taxation. Recently, the CBDT issued a circular enumerating guidelines on exemption of receipts received from high premium ULIP. To read our detailed analysis, please go to : https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-issues-guidelines-on-the-availability-of-exemption-in-case-of-high-premium-u

[Circular No. 2/2022, dated 19 January 2022]

CBDT notifies mechanism for computing capital gain and Securities Transaction Tax Rules for ULIPs

Recently, the CBDT inserted Rule 8AD to Income-tax Rules, 1962 (IT Rules) providing a mechanism to compute capital gains from certain specified ULIPs. Further, in addition to the above, in order to ensure compliance from the ULIP issuers i.e. the life insurance companies, the CBDT has amended the Securities Transaction Tax Rules, 2004 and incorporated insurance companies as a prospective

compliant of its provisions. To read our detailed analysis, please go to : https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-mechanism-for-computing-capital-gain-and-securities-transaction-tax-rules-for-uli

[Notification No.8 & 9/2022, dated 18 January 2022]

Due dates for filing of Income Tax Returns and audit reports for FY 2020-21 further extended by CBDT

Considering that the due date of tax compliances was approaching, and the taxpayers and other stakeholders are still facing difficulties due to COVID and electronic filing of various reports of audit under the provisions of IT Act, the CBDT has provided relaxation in respect of certain tax compliances by issuing a circular. To read our detailed analysis, please go to : https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-due-dates-for-filing-of-income-tax-returns-and-audit-reports-for-fy-2020-21-furth

[Circular No. 1/2022, dated 11 January 2022]

JUDICIAL UPDATES

Services rendered outside India by non-resident for Indian company's business outside India are not taxable as FTS

Taxpayer, company incorporated in and tax resident of Singapore, is organized as a support and business development center for providing advice, support and assistance in the area of marketing and sales to group companies in Southeast Asia region through experienced personnel. For the relevant year under consideration, taxpayer had entered into a service agreement with its Indian subsidiary to render marketing services for the benefit of the Indian company. The tax officer opined that the taxpayer was assisting the Indian subsidiary in market research, product launch, price negotiations, consultancy services by the experienced personnel and also on sales and marketing matters. Thus, the tax officer treated the receipts from the

TAX UPDATES
Direct Tax

Indian subsidiary taxable as fees for technical services (FTS) under the IT Act as well as the Double Tax Avoidance Agreement (DTAA). The Dispute Resolution Panel upheld the order of the Tax Officer. Aggrieved, the taxpayer filed an appeal before the Bangalore Tax Tribunal which granted relief to taxpayer and made the following observations:

- The Indian subsidiary had entered into an agreement with the taxpayer as a Company and not with the employee of the taxpayer, who was rendering the market research and sales support services. Thus, it cannot be considered similar to case of secondment of employee as the employee of taxpayer on behalf of taxpayer is rendering the relevant services to Indian subsidiary. Further such services were rendered by the taxpayer outside India.
- The Delhi Tax Tribunal in the case of Lufthansa Cargo India Pvt Ltd[1] and Titan Industries Ltd[2] held that as the source of earning income was outside India, the amount paid will be covered in exception provided under section 9(1)(viib) of the IT Act. Further, while dealing with the exception under section 9(1)(viib) of the IT Act, Hon'ble Supreme Court in the case of GVK Industries Ltd[3] observed that, such exception applies to a situation when fee is payable in respect of services utilized for business or profession carried out by an Indian taxpayer outside India or for the purpose of making or earning of income from any source outside India.
- The services rendered by taxpayer to Indian subsidiary were 'managerial' in nature. However, such services were utilized for Indian subsidiary's business outside India. Therefore, such services cannot be deemed to have been accrued or arisen in India and not taxable as per the IT Act.
- As per Article 12(4)(b) of the India-Singapore DTAA, not only the payment should be in consideration for rendering of technical or consultancy services, but in addition to this, the services so rendered should also 'make available' technical knowledge, experience, skill, know-how, or processes, or consist of the development and transfer of a technical plan or design.
- The Mumbai Tax Tribunal in the case of Raymond Ltd[4] had considered the meaning of expression 'make available' and held that rendering of technical services cannot be equated with making available the technical services. Further, while dealing with similar issue, Karnataka High Court in the case of De Beers India Minerals (P) Ltd[5] held that if the technology is not made available along with the technical services and what is rendered is only technical services and the technical knowledge is withheld, then, such a technical service would not fall within the definition of technical service in DTAA and not liable to tax.

[Orkla Asia Pacific Pte Ltd v. DCIT, ITA No. 193/Bang/2019 (Bangalore Tribunal)]

Reassessment notices issued post 31 March 2021 should be issued as per new procedures

Several taxpayers received notices under the erstwhile section 148 of the IT Act between 1 April 2021 to 30 June 2021 even through sections 147 to 151 of the IT Act were substituted with effect from 1 April 2021. Hence, they filed writ petition before the Delhi High Court challenging the validity of such notices as well as the extension notifications (31 March 2021[6] and 27 April 2021[7]) challenging the notices issued. While ruling in favour of the taxpayer, the Delhi High Court made following observations:

- **Legislature permits re-assessment only in accordance with the new assessment regime:**
  - By virtue of section 1(2)(a) of the Finance Act 2021, the new reassessment regime came into force from 1 April 2021. The expression "shall" in Section 1(2)(a) of the Finance Act 2021 was in contrast to the language under section 1(2)(b) of the Finance Act 2021 which stated that sections 108 to section 123 of the Finance Act 2021 shall come into force on such date as notified in the Official Gazette.
  - There was no power with the Revenue to defer/ postpone the implementation of the new reassessment regime.
  - It is a settled position that the law prevailing on the date of issuance of the notice under section 148 of the IT Act has to be applied.
  - If the intention of the legislature had been to keep the Old Law alive, it would have introduced the New Law with effect from 1 July 2021, which has not been done.
  - Accordingly, reassessment notices relating to any year issued under section 148 of the IT Act on or after 1 April 2021 have to comply with the provisions pertaining to new reassessment regime as substituted by Finance Act 2021 w.e.f. 1 April 2021.
  - When legislature has permitted reassessment to be made in accordance with the amended provisions, it had to be done in this manner only, or not at all.

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[1] Lufthansa Cargo India Pvt. Ltd. vs. DCIT [2004] 91 ITD 133 (Delhi Tax Tribunal)
[2] Titan Industries Ltd vs. ITO [2007] 11 SLT 206 (Delhi Tax Tribunal)
[3] GVK Industries Ltd vs. ITO [2015] 371 ITR 453 (Supreme Court)
[4] Raymond Ltd vs. Dy. CIT [2003] 86 ITD 791 (Mumbai Tax Tribunal)
[5] CIT vs. De Beers India Minerals (P) Ltd [2012] 21 taxmann.com 214 (Karnataka High Court)
[6] Notification No. 20/2021/F. No. 370142/35/2020-TPL, dated 31 March 2021. Refer our tax alert- https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-further-extends-few-statutory-deadlines
[7] Notification No. 38/2020/F. No. 370142/35/2020-TPL, dated 27 April 2021. Refer our tax alert- https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-further-extends-few-statutory-deadlines-and-payment-under-vivad-se-vishwas-s

TAX UPDATES
Direct Tax

- **Relaxation Act empowered the Government to extend only the timelines:**
  - Section 3(1) of the Relaxation Act only extended the timelines for the actions specified. It did not delegate power to the Government to extend the applicability of the erstwhile provisions beyond 31 March 2021 or to postpone the applicability of the amended provisions which has been enacted from 1 April 2021.
  - Relaxation Act and notifications issued thereunder can only change the time-lines applicable to the issuance of notice under section 148 of the IT Act. They cannot change the statutory provisions applicable thereto.
- **Explanations in the Notifications dated 31 March 2021 and 27 April 2021 are ultra vires the Relaxation Act:**
  - The impugned explanations were not only beyond the power delegated to the Government but also in conflict with the provisions of the IT Act which specifically made the new reassessment regime applicable from 1 April 2021.
  - There was no scope for any implied delegation of authority and the delegated authority must act strictly within the parameters of the authority delegated to it.
  - Referring to Supreme Court ruling in the case of Lachmi Narain[8], subordinate legislation cannot be contrary to the parent statute. Consequently, explanations A(a)(ii)/A(b) to the notifications dated 31 March 2021 and 27 April 2021 are ultra vires the Relaxation Act 2020 and are therefore, bad in law and null and void.
- **Power of Reassessment:**
  - Hohfeld's theory on jural relations does not come to the aid of the tax authorities. There was no dispute that as per Hohfeld's theory, the jural correlative of "power" is "liability". Where there was power, there was corresponding liability imposed upon the person against whom such power exists.
  - However, with the amended provisions coming into effect from 1 April 2021, there was no curtailing or taking away of Revenue's power to reassess. It merely changed the procedure for issuance of notice. Consequently, the "power" as per Hohfeld's theory that existed prior to 31 March 2021 continued to exist even thereafter.
- **Ignoring the Legislative Intent:**
  - Even prior to Finance Act 2021, legislature enhanced/reduced time limits specified in Section 149 of the IT Act and such changes were made effective from different dates of the relevant fiscal years.
  - While interpreting the applicability of an earlier amendment to section 149 of the IT Act, coordinate bench in the case of C. B. Richards Ellis[9] held that the reduced time limit applied with effect from the Finance Act coming into force.
- **Substantive Law vs. Procedural Law:**
  - It is a cardinal principle of construction that every statute is prima facie prospective unless it is expressly or by necessary implication made to have retrospective operation.
  - In contrast to statutes dealing with substantive rights, statutes dealing with matters of procedure are presumed to be retrospective, unless such construction is textually inadmissible.
- **The intent, purpose and scope of the amendments:**
  - To ascertain the nature of legislation, it was necessary to determine the intent, purpose and scope of the amendments. On referring to Finance Minister's Budget Speech, the intent, scope and purpose of the amendments was to protect the rights and interest of the taxpayers as well as to promote the public interest.
  - It was settled law that if the legislation was introduced to remedy the defective rule and no one suffered thereby, it was sensible to apply it to pending proceedings.
  - The legislature being conscious of the shortcomings in the unamended sections 147 to 151 of the IT Act (which were relaxed by the provisions of Relaxation Act and notifications issued thereunder) introduced reformative changes to the said sections governing the procedures for reassessment proceedings by way of the Finance Act 2021. The legislative intent behind this substitution / amendment was to reduce litigation and compliance burden, remove discretion, impart certainty and promote ease of doing business.
- **Substitutions made by the Finance Act 2021 is not applicable to past AY:**
  - Circular 549 of 1989 issued by the CBDT explaining the provisions of the Direct Tax Laws (Amendment Act) 1989 amending the erstwhile sections 147 to 152 of the IT Act had clarified that the said provisions were procedural in nature and would have retrospective effect unless the amending statute provided otherwise.
  - Reliance of the tax authorities on this Circular was contradicting in as much as for three months (from 1 April 2021 to 30 June 2021), the amendments made by the Finance Act 2021 was considered as substantive in nature and hence applicable prospectively. While from 1 July 2021, the same amendment will be considered as procedural and hence will be applicable retrospectively for any AY including earlier years.

[8] Lachmi Narain vs. UOI AIR 1976 SC 714
[9] C.B. Richards Ellis Mauritius Ltd vs. ADIT [2012] 208 Taxman 322 (Delhi High Court)

TAX UPDATES
Direct Tax

- Therefore, in view of its own submission and past precedent to treat section 147 to 152 of the IT Act as procedural, the tax authorities are estopped from contending to the contrary.

- **Applicability of old procedure of reassessment beyond 31 March 2021 could lead to manifest arbitrariness and conflict:**
  - If tax authorities contend that the Explanation in Notification dated 31 March 2021 extended the applicability of old reassessment procedure beyond 31 March 2021 was accepted, the same could lead to arbitrariness because:
    - During the period 1 April 2021 to 30 June 2021 both old and new procedures would operate simultaneously;
    - 'Doctrine of election' normally confers two separate alternative statutory powers. But same provision with two opposite procedure for same cause can never be envisaged and shall necessarily lead to manifest arbitrariness and conflict.
- **Tax Authorities cannot rely on COVID-19 for contending that the new reassessment regime should not operate during the period 1 April 2021 to 30 June 2021:**
  - At the time of introduction as well as enactment of Finance Bill, 2019, COVID-19 was widely prevalent, and the Parliament was fully aware of the same.
  - Therefore, the tax authorities cannot rely on COVID-19 for contending that the new reassessment regime did not operate during the period 1 April 2021 to 30 June 2021 or that the Relaxation Act dealt with the situation arising out of COVID-19 and the Finance Act 2021 was passed being oblivious of the COVID-19 pandemic.
- **Non-Obstante Clause has to be construed strictly:**
  - The non-obstante clause in section 3(1) of the Relaxation Act has to be construed strictly and has an overriding effect over the other statutes only to the extent it expressly so provides.
  - In the present case, the ambit of non-obstante clause in the Relaxation Act is expressly confined to and supersedes the time limits only for the completion or compliance of actions which are laid down in the Specified Acts and the Relaxation Act only provides that these time limits shall stand extended as provided.
  - Thus, the said non-obstante clause only operated to prevail over the timelines laid down in the Specified Acts. Apart from these timelines, no other provision of any Specified Act was suspended or overridden.
  - The Relaxation Act was enacted long before the Finance Act 2021. Consequently, it could not possibly be contended that any provision of Relaxation Act much less of any Notification issued thereunder, could amend or modify or exclude the applicability of the yet to be enacted Finance Act 2021.
- **Legal fiction/ Stop the Clock provisions and section 6 of the General Clause Act:**
  - The extension of time for completing an assessment or issuing a notice under section 148 of the IT Act has no element of legal fiction in it. The only effect and consequence of this extension of the time limit was that if the Act in question is performed within the extended time limit, it will be considered to be legally compliant.
  - Section 3 of the Relaxation Act was not a stop the clock provision since the essential condition for a provision to be termed as stop the clock provision was that time during which such clock is stopped, such period has to excluded. In the present case, time limit is extended, not excluded or stopped.
  - Tax Authorities' submission that section 6 of the General Clauses Act saves notices issued under section 148 of the IT Act was untenable in law, since in the present case, the repeal was followed by a fresh legislation on the same subject and the new Act manifested an intention to destroy the old procedure.

[Mon Mohan Kohli vs. ACIT & ANR [2021] W.P. (C) 6176/2021 and others (Delhi High Court)]

TAX UPDATES
Transfer Pricing

Final Order passed without DRP's direction is illegal and without jurisdiction

Draft Assessment order was passed on 27 August 2021. In terms of section 144C of the Income-tax Act, 1961 (IT Act), the taxpayer had two options - (i) accept the order and file his acceptance (ii) file objection before the Dispute Resolution Panel (DRP). The taxpayer filed an objection with DRP on 24 September 2021. Owing to change in the mechanism of assessment being shifted to the faceless scheme coupled with Covid-19 pandemic, the Tax Payer intimated the Tax Officer only on 4 October 2021. However, the Tax Officer passed the final order dated 30 September 2021 without awaiting directions from the DRP. Hence, the taxpayer filed a writ before the Karnataka High Court against the final order passed the Tax Officer.

Karnataka High Court while accepting the reason for not intimating the Tax Officer before 4 October 2021 took note of Government orders, circulars etc. as well as the orders of Apex Court extending the period of limitation. The High Court also observed that the Taxpayer had chosen to exercise the option of filing objections to the draft Tax Order warranting the DRP to proceed further before the Tax Officer passes the final order. Since the Tax Officer passed the final order without waiting for the disposal of objection, the said order was arbitrary, illegal and without jurisdiction or authority of law. Accordingly, the High Court directed DRP to conclude the proceedings by considering the objections filed by the taxpayer.

Marvell India Private Limited vs NFAC [TS-706-HC-2021 (Kar)-TP]

Slump sale not a Specified Domestic Transaction and hence penalty under section 217AA deleted

The Taxpayer is engaged in the business of manufacturing and processing of Soya Oil. During the course of assessment, the Tax Officer observed that the taxpayer has entered into a transaction of acquisition of an undertaking by way of slump sale from its sister concern - M/s. Ruchi Soya Industries Limited. While the taxpayer submitted that the said transaction is not covered by the definition of specific domestic transaction (SDT), Tax Officer opined that it is SDT. Accordingly, he initiated penalty proceedings under section 271AAof the IT Act for not reporting the said transaction and failing to keep and maintain any such information as required under section 91D(1) and 91D(2) of the IT Act. Thereafter, the Tax Officer levied penalty on the taxpayer. The First Appellate Authority granted deleted the penalty so levied.

Upholding First Appellate Order, Tax Tribunal held that the penalty is leviable on SDT or an international transaction if the taxpayer does not fulfill any of the following 3 conditions:

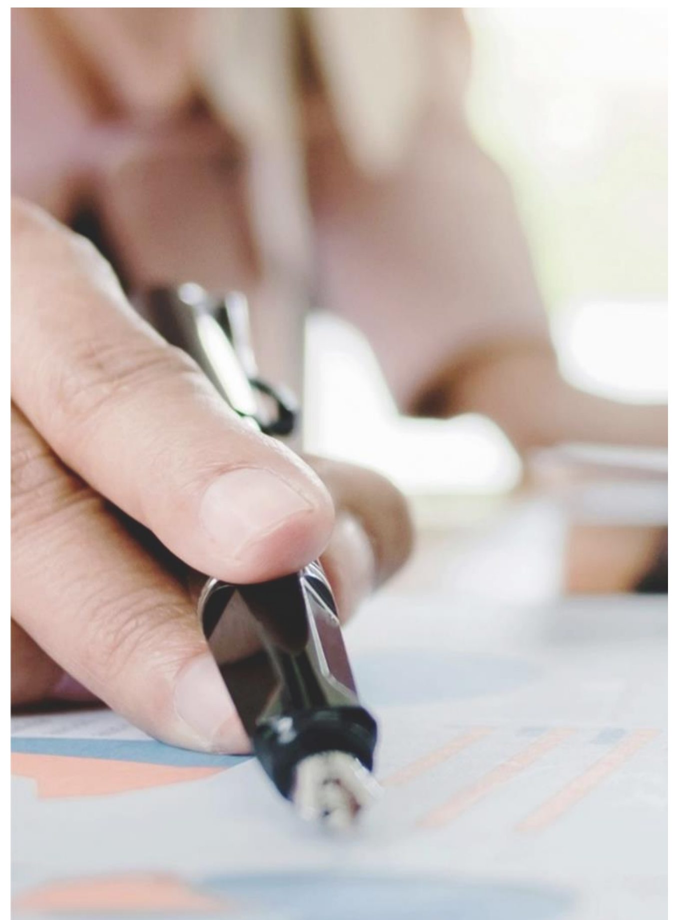
- Fail to keep and maintain any such information and documents as required under section 91(1) and section 91(2) of the IT Act
- Fails to report such transaction which is required to do so
- Maintain or furnish or incurred information or document

In the instant case, the taxpayer fulfilled all the above-mentioned conditions, viz.,

- The taxpayer has duly disclosed the Slump Sale transaction in its regular books of account
- There is no finding of Tax Officer that the particulars furnished related to SDT are inaccurate or suffers from any defect.
- Said transaction is not expenditure as contemplated in the definition of a SDT defined under section 92B of the IT Act
- The auditor has also incorporated the said transaction in Form 3CEB by way of giving specific note about slump sale not to be treated as "SDT“

Hence, the Tax Tribunal upheld the First Appellate Authority. The Tax Tribunal observed that the penalty notice issued by the Tax Officer is vague as it did not clearly bring out the purported default for which the penalty is to be levied.

ACIT vs Ruchi J. Oil Pvt. Ltd [TS-31-ITAT-2022(Ind)-TP]



TAX UPDATES
Indirect Tax

GOODS & SERVICE TAX

JUDICIAL UPDATES

WRIT PETITION

Electronic Credit Ledger(ECL) cannot be blocked under Rule 86A beyond one year

Facts of the case

M/s. Barmecha Texfab Private Limited's (Taxpayer) ECL was blocked for a period more than one year. The Taxpayer has filed a Writ Petition seeking a direction to be issued to the tax authorities to unblock the ECL as the period of 1 year under sub-rule 3 of rule 86A of the CGST Rules, 2017 has elapsed from the date of order of blocking the ECL.

Contention of the Taxpayer

- The taxpayer relied on sub-rule 3 of rule 86A which provides that ECL can be blocked only for a period of 1 year. Also, after the expiry of one year, the same should be unblocked automatically;
- The taxpayer had also filed representation to the tax authorities, but the authority did not pay heed to such representation;
- Considering that the tax authority did not allow the taxpayer to avail the credit in his ECL for more than two and half months after the expiry of period of one year, the same should be unblocked.

Observations and Ruling by the High Court

- The hon'ble High Court held that, the rule itself has provided that the ECL can be blocked for a period of one year;
- On expiry of a period of one year, it should be automatically get unblocked. In fact, it was the duty of the tax authority concerned to permit the taxpayer to avail the input credit available in his ledger;
- Once the statutory period ends, the tax authority has no further discretion in the matter, unless a fresh order is passed;
- Based on the above findings, the High Court has disposed of the case and directed the tax authority to unblock the ECL.

  [Barmecha Texfab Private Limited vs Commissioner Government Of Gujarat, 2022-TIOL-136-HC-AHM-GST 12 January 2022]

ORDERS BY AUTHORITY FOR ADVANCE RULING (AAR)

Membership fee, subscription fee collected by club from its members is liable to GST

Facts of the case

M/s. Poona Club Limited ('Taxpayer') is a sports club which collects following charges from its members:

- Membership fee at the time of giving membership and is capitalised as corpus funds of the club and are either invested in financial assets or are mainly spent for creation of assets of the club;

- Annual subscription and annual games fee which is used for administration of club;
- Fee along with GST at the rates determined by the taxpayer for providing facilities and services to the extent of use.

Questions before the AAR

- Whether membership fee collected from members at the time of giving membership is liable to tax under CGST/SGST Act, 2017?
- Whether the annual subscription and annual games fee collected from members of club is liable to tax under CGST/SGST Act?

Contention of the Taxpayer

- The taxpayer contended that the main objects of club is promotion of sport activities and there is no commercial nature to the activities carried-out by the club;
- The taxpayer further contented that the membership fee charged do not give any right to use facilities given by the taxpayer;
- That the principle of mutuality is also applicable to annual subscription and annual game fee collected by club from its members as the same is used for administration of club;
- The case of Prestige South Ridge AAR Karnataka[Order no:KAR-ADRG 42/2019 dated 17 September 2019] was relied upon by the taxpayer which held that corpus or sinking fund collected from members is not liable for levy of GST as such initial contribution cannot qualify as a "consideration" as defined in the CGST Act, 2017;
- The taxpayer also relied on the decision in the case of Lions club of Pune [Order No:MAH/AAAR/SS-RJ/32A/2018-19], wherein the AAAR, Maharashtra has held that membership fees collected from members to be spent on administration of club will not be construed as consideration for supply for levy of GST;
- The Supreme Court has held in Commissioner of Sales Tax v Sai Publication Fund [(2002) 4 SCC 57] held that if the main object of the trust is not commercial in nature, then the fact that the incidental objects require sale and purchase of goods is irrelevant. Thus, if the main object is not commercial in nature, then the entire activity falls outside the definition of "business";

TAX UPDATES
Indirect Tax

- The ordinary meaning of "business" requires profit motive to be established [State of AP v H. Abdul Bakshi (1964) 15 STC 644 (SC)). Section 2(17)(e) overrides the judgment of State of AP v H. Abdul Bakshi by using the words "whether or not...for pecuniary benefit". However, it can be seen that these words making profit motive irrelevant are used only in section 2(17)(a) of CGST Act, 2017 and not in any of the other sub-clauses;
- The taxpayer further submitted that the amendment to section 7 of the CGST Act, 2017 was brought about by section 108 of the Finance Act, 2021 which was not yet notified as on the date of the final hearing.

Observations and ruling by the AAR

- The AAR noted that the contention of the taxpayer that 'pecuniary benefit' means 'profit' is not correct;
- Black's Law Dictionary defines the term "pecuniary benefit" as monetary benefits. An award or compensation or benefit that is quantifiable in monetary terms;
- Therefore, undertaking of a commercial activity, whether or not the same is for pecuniary benefit (used in clause above), implies that whether or not such activity yields the benefit which can be quantifiable in monetary terms or not. Hence the intent behind the said clause is to even cover the commercial transactions which are in the nature of barter or exchange wherein the benefit is in non-monetary terms;
- Further, sub-clause (e) of section 2(18) of CGST Act, 2017 is a specific clause made for associations, clubs and societies and the same does not talk about any profit motive;
- The observation/decision of the Hon'ble Supreme Court cited by the taxpayer was related to the erstwhile Bombay Sales Tax Act, 1959 and is therefore not applicable under the GST Laws;
- Relevant amendment has been notified by the Central Government vide notification no:39/2021-CT dated 21 December 2021;
- The AAR held that membership fee, annual subscription and annual games fee collected from members is liable to GST.

[AAR-Maharashtra, M/s. Poona Club Limited, Ruling no: GST-ARA-123/2019-20/B-12 dated 31 January, 2022]

Drilling and blasting method used for construction of tunnel issued under a work order in a sub-contract be classified as a composite supply of 'works' contract'

Facts of the case

- M/s. Kapil Sons ('Taxpayer') is engaged in business of drilling and blasting works using Industrial explosives and other materials at various sites;
- Maharashtra State Road Development Corporation Limited ('MSRDC', a fully owned corporation by the state of Maharashtra) entered into an Engineering, Procurement and Construction (EPC) agreement on 11 October 2018 with M/s. Navyauga Engineering Company Limited for construction of two tunnel (Two tubes of four lane each) for missing link under capacity augmentation of Mumbai-Pune expressway in the state of Maharashtra under EPC mode;
- M/s. Navyuga then further sub-contracted the blasting work to the taxpayer who sought the advance ruling for the following questions.

Question raised before AAR

- Whether the activity to be carried-out by the taxpayer shall be classified as supply of goods or services or a composite supply of 'works' contract'?
- Whether the activity should be classified as composite supply of works contract for construction of tunnel under entry 3(iv) of notification no:11/2017-CT (R) dated 28 June 2017 taxable at the rate of 12%?

Contention of Taxpayer

Taxpayer is of view that the activity carried-out by him shall be classified as 'works contract' and get covered under entry in entry no:3(iv) of notification no:11/2017-CT(R) dated 28 June 2017 taxable at 12% under HSN 9954 relying on the decisions in the cases of "three judge bench of Supreme Court in Larsen and Toubro limited and another vs. State of Karnataka and another (2014) 1 SCC 708 = 2013-TIOL-46-SC-CT-LB." and "State of Gujarat Us. Bharat Pest Control [Civil Appeal No.1335 of 2018] = 2018-TIOL-310-SC-VAT". The taxpayer opined that all the conditions of works contract under section 2(119) are fulfilled.

Observations and ruling by the AAR

- The AAR observed that the activity undertaken by the taxpayer involves supply of both the goods as well as the services and it also observed that the work order provided by the taxpayer clearly mentions the fact that the activity is classified as composite supply of works contract for construction of tunnel;
- In response to the first question, AAR held that the activity carried-out by the taxpayer is a composite supply of goods and services as defined in section 2(30) and 2(119) of CGST Act, 2017 and as the same is relating to construction of tunnel it gets covered under entry 3(iv) of notification no:11/2017-CT(R) dated 28 June 2017;
- The AAR also relied on the judgment submitted by the taxpayer relating to decision of Advance Ruling Authority of Gujarat in case of M/s KHEDUT HAT [2018- TIOL-173-AAR-GST] where similar ruling is passed classifying the blasting work with use of explosives as a composite supply;
- The AAR held that the activity carried-out by the taxpayer shall be classified as a composite supply of 'Works contract' covered under entry 3(iv) of notification no:11/2017-CT (R) dated 28 June 2017 at the rate of 12%

[AAR, Maharashtra-M/s. Kapil Sons, ruling no:GST-ARA-05/2021-22/B-17, dated 08 February 2022]

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