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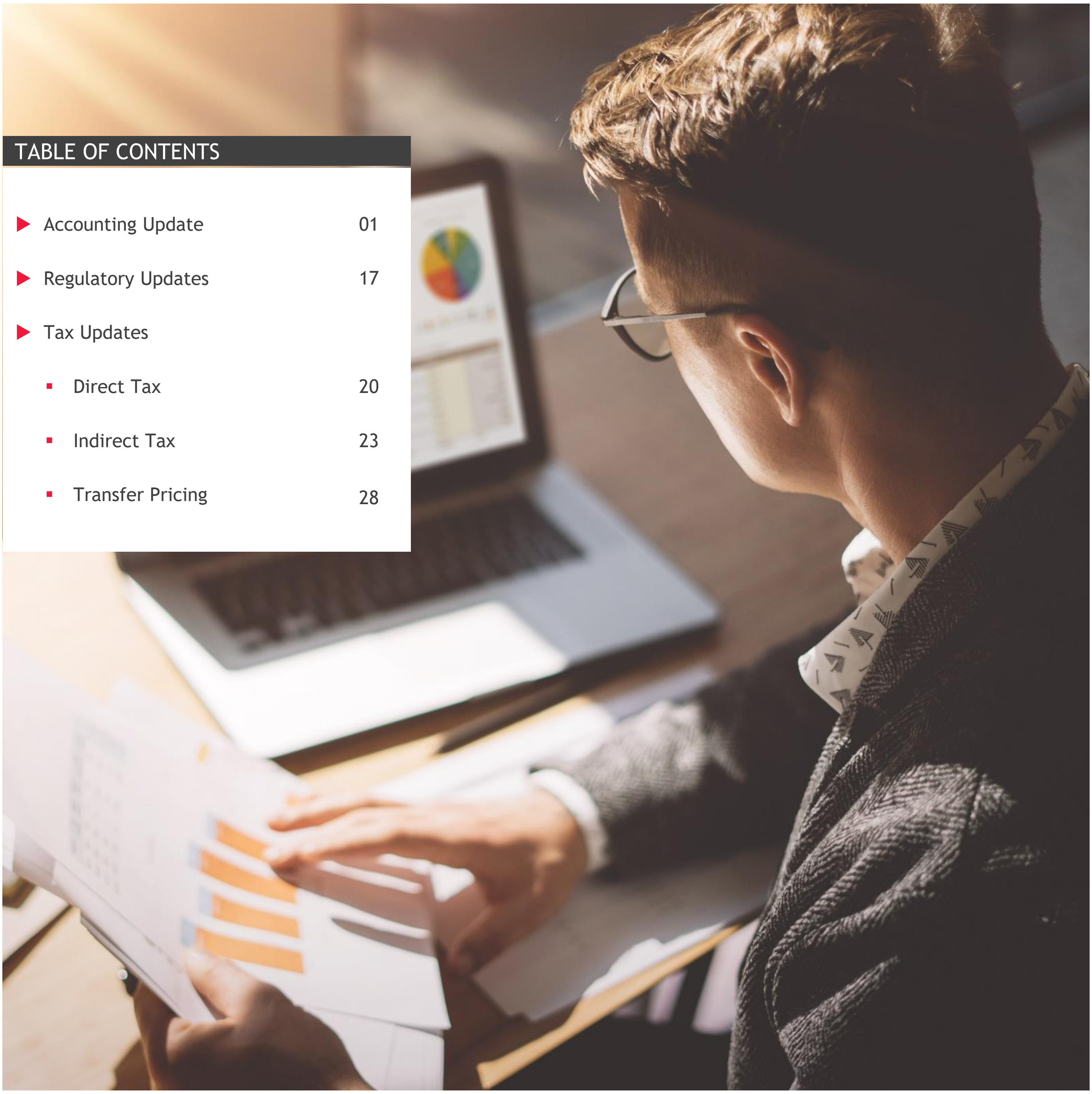

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ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

EAC OPINION

CLASSIFICATION OF RAIL CORRIDOR ASSET IN THE BOOKS OF ACCOUNT OF THE COMPANY AS TANGIBLE/INTANGIBLE ASSET AND ITS DEPRECIATION/AMORTISATION

Facts of the Case:

A Memorandum of Understanding (MoU) was signed between the Government of Chhattisgarh (GoCG), SE Limited and I Limited on 3 November 2012 to create project specific Special Purpose Vehicle (SPV) in the State of Chhattisgarh for developing the rail network. After the signing of the MoU, a Company (hereinafter referred to as 'the Company'), being a subsidiary of SE Limited has been incorporated on 12 March 2013 as a special purpose vehicle under the joint venture model of Public-Private-Partnership (PPP) policy of Ministry of Railways (MoR). The Company has stated that SE Ltd. is a wholly owned subsidiary of C Limited. Accordingly, C Ltd. is the ultimate holding company of the Company.

The Company, being a joint venture company of SE Limited, I Limited and GoCG (represented by State Industrial Development Corporation (SIDC)) was incorporated for developing the rail network and to facilitate coal traffic movement. Ministry of Railways (Government of India) has notified the East Rail Corridor in the State of Chhattisgarh as a 'Special Railway Project' to provide a national infrastructure for a public purpose and directed for the acquisition of land under the Railways Act, 1989.

The Company has been formed with equity contributions from SE Ltd., I Ltd. and GoCG. The role of promoters is to bring the necessity of rail infrastructure and its establishment to a common platform so that the desired objective can be achieved by an association for a limited period. While discharging the promoters' role, SE Ltd. looks for an eco-friendly coal evacuation process through rail, I Ltd. shares the technical expertise to move on the rail, and GoCG provides the government land required for the project.

Project Execution Agreement

The Company has stated that for undertaking the construction of the Rail Corridor, the Company has executed the Project Execution Agreement with I Ltd. on 18 January 2014, having domain expertise on the execution of railway projects to act as a Project Management Consultant for undertaking the construction work of the proposed rail project in two phases.

The scope of work to be carried out by I Ltd. as per the agreement includes the activities like route selection, land acquisition, detailed survey work, project costing, preparation of feasibility/bankability report to establish the project cost, a compilation of land data feasibility study, resettlement and rehabilitation (R&R) work, recurring assistance in R&R activity, preparation of detailed project report (DPR), construction & completion of a rail network, arrangements under concession agreement, clearance and diversion of forest land for the project as per the provisions of Forest Conservation Act, 1980 etc.

Concession Agreement

The Company executed the Concession Agreement with Southeast Central Railway (SECR) (Zonal Railway) on 12 June 2015, to be read with Addendum and Corrigendum to the Concession Agreement executed on 21 March 2017. This Agreement defines the roles and obligations of the Ministry of Railways (MoR) and the Company, including revenue sharing.

It is an important milestone in the execution of the project. A Concession Agreement will also facilitate in arranging commitment from the banks/ financial institutions for achieving financial closure.

A Brief Concession Agreement is defined as under:

1	Objective	To Build, Operate and Maintain an Approved Rail System
2	The Concessionaire	A nominee of the Indian Railways (the Company)
3	Period of Concession	30 years including the construction period extendable by 5 years
4	Revenue Sharing	Normally 50% of freight revenue collected by Railways from customers with the Concessionaire i.e., The Company (User Fee)
5	Land Acquisition	Under the Indian Railways Act at the cost of Concessionaire
6	Land Cost	Non-interest-bearing deposit with Railways till termination
7	Completion	Can be done in Phases at the cost of the Concessionaire
8	Target Traffic	To achieve the agreed Net Tonne Kilometre (NTKM) over the period of Concession i.e., 30 years
9	Maintenance	Either by MoR or Concessionaire at the cost of the Concessionaire
10	Security	To be ensured by Concessionaire
11	Insurance	To be ensured during Concession Period by Concessionaire
12	Operation	By Railways
13	Supervision	Through Independent Engineers

Obligations of Concessionaire

To Build and Maintain the Rail System during the Concession Period
Acquire the Site (Land) for Rail System
Execute and procure the execution of the Escrow Agreement and Substitution Agreement
Procure applicable permits
Execute and deliver to MoR, the Financing Agreements and deliver to MoR, the Financial Package and Financial Model

Obligations of the Ministry of Railways

Provide reasonable support in procuring applicable permits
Provide Railway Land and Right of Way
Undertake interconnection of the Rail System with the Rail Network
Pay the User Fee to the Concessionaire
Provide a timely supply of a sufficient number of rakes, wagons, locomotives and other rolling stock
Support, cooperate with and facilitate the implementation and operation of the Project
Safety Certificate and Commercial Service Certificate

Relevant Clauses of the Concession Agreement are as under:

As per clause 3.1.1 of the Concession Agreement entered with the Ministry of Railways (through SECR), the Company has received by way of exclusive right, license and authority to construct, operate & maintain the rail system, excluding the performance of the Reserved Services, for 30 years commencing from the Appointed Date and the Concessionaire has accepted the Concession and agreed to implement the project subject to and per the terms and conditions of the Concession Agreement.

Clause 3.1.3 of the Agreement states that:

"Subject to and in accordance with the provisions of this Agreement, the Concession hereby granted shall oblige or entitle (as the case may be) the Concessionaire to:

- Right of Way, access and license to the Site for the purpose of and to the extent conferred by the provisions of this Agreement
- Finance and construct the Rail System
- Operate and maintain the Rail System
- Receive the User Fee from MOR for using the Rail System or any part thereof
- Perform and fulfil all of the Concessionaire's obligations under and in accordance with this Agreement
- Bear and pay all costs, expenses and charges in connection with or incidental to the performance of the obligations of the Concessionaire under this Agreement and
- Neither assign, transfer or sublet nor create any lien or Encumbrance on this Agreement, nor the Concession hereby granted nor on the whole or any part of the Rail System nor transfer, lease or part possession thereof, save and except as expressly permitted by this Agreement or the Substitution Agreement.

Clause 3.2 of the Concession Agreement relating to 'Railway Administration' states that:

"The Parties agree that the Concessionaire shall be deemed to be a Railway Administration (as defined in the Railways Act, 1989) for construction, operation and maintenance of the Rail System, and shall exercise the rights and perform the obligations of the Railway Administration as specified under the provisions of the Railways Act, 1989, however, such rights and functions shall at all times be subject to the provisions of this Agreement."

Clause 10.2 of the Concession Agreement relating to 'License, Access and Right of Way' states that:

"10.2.1 MOR hereby agrees to grant to the Concessionaire access to the Site for carrying out any surveys, investigations and soil tests that the Concessionaire may deem necessary before the commencement of the Construction Period, it is expressly agreed and understood that MOR shall have no liability whatsoever in respect of survey, investigations and tests carried out or work undertaken by the Concessionaire on or about the Site pursuant hereto in the event of Termination or otherwise.

10.2.2 In consideration of the Concession Fee, this Agreement and the covenants and warranties on the part of the Concessionaire herein contained, MOR, in accordance with the terms and conditions set forth herein, hereby grants to the Concessionaire, commencing from the Appointed Date, leave and license rights in respect of all the land (along with any buildings, constructions, construction materials or immovable assets, if any, thereon) comprising the Site which is described, delineated and shown in Schedule-A hereto , on an "as is where is" basis, free of any Encumbrances, to develop, operate and maintain the said Licensed Premises, together with all and singular rights, liberties, privileges, easements and appurtenances whatsoever to the said Site, hereditaments or premises or any part thereof belonging to or in any way appurtenant thereto or enjoyed therewith, for the duration of the Concession Period and, for the purposes permitted under this Agreement, and for no other purpose whatsoever.

10.2.3 The license, access and right of way granted by this Agreement to the Concessionaire shall always be subject to existing rights of way and the Concessionaire shall perform its obligations in a manner that existing lanes, if any, along the alignment of or across the Rail System or an alternative thereof are open to road traffic at all times during the Construction Period.

10.2.4 It is expressly agreed that the license granted hereunder shall terminate automatically and forthwith, without the need for any action to be taken by MOR to terminate the license, upon the Termination of this Agreement for any reason whatsoever. For the avoidance of doubt, the Parties expressly agree that notwithstanding any temporary or permanent structures erected on the Site by the Concessionaire or its sub-licensees, the license in respect of the Site shall automatically terminate, without any further act of the Parties, upon Termination of this Agreement."

From the above clauses of the Concession Agreement, the Company (the concessionaire or the operator) has been formed as a special purpose vehicle (SPV) of SE Ltd., I Ltd. and State Industrial Development Corporation for the development of rail corridor for transportation of coal in the Mand-Raigarh Coalfields region of Chhattisgarh. The said Concession Agreement with the Ministry of Railways through SECR provides the Company with an exclusive right, license and authority to construct operate and maintain the rail system. The Company is entitled to receive 50% of the revenue apportionment from freight operation on the rail system.

Accounting Policy of the Company:

Property, Plant & Equipment

Land

The land is carried at historical cost. Historical cost includes expenditure which is directly attributable to the acquisition of the land like rehabilitation expenses, resettlement cost and compensation instead of employment incurred for concerned displaced persons etc. Value of land acquired by the Ministry of Railways (MoR) for the project at the cost of the Company shall remain as a noninterest-bearing refundable advance till the termination of the Concession period and it includes the cost of acquisition, cash rehabilitation expenses, resettlement cost and all other incidental expenses incurred for the acquisition of project land as provided in the Concession Agreement.

Rail Corridor Asset

Expenses incurred by the Company on certain activities which are essential for the construction, operation and maintenance of the Rail System of the Company are recognized as Rail Corridor under Construction till Commercial Operation Date (CoD). After CoD, including Stage-wise CoD, the assets are classified as Rail Corridor and depreciated/ amortised based on the Agreed Targeted Traffic based on the Concession Agreement. Accordingly, Rail Corridor is being shown under the head ‘Property, Plant & Equipment’ and is being depreciated based on Progressive Target Traffic.

Commercial Operation:

The project is brought to revenue when the commercial readiness of a project to yield revenue on a sustainable basis is established based on Certification by the Commissioner of Railway Safety (CRS) as per the Concession Agreement or by any other Authority as per rules and regulations of MoR/SECR for the project including stage-wise certification, if any.

On being brought to revenue, the assets under capital work in progress are reclassified as a component of property, plant and equipment under the nomenclature “Rail Corridor”. Rail Corridor is amortised from the year when the Rail Corridor is brought under revenue in the total NTKM (Target Traffic) to be achieved as per the Concession Agreement to be read with Addendum and Corrigendum to the Concession Agreement.

Stage-wise Commercial Operation Notification:

Financial year (F.Y.) 2019-20:

With the issuance of Notification by GM/SECR vide Memorandum dated 28 September 2019, wherein approval was accorded for the operation of Goods Trains with diesel traction on the newly constructed BG Track from Kharsia to Korichhapar (42.569 Km length), the Company created the Rail Corridor Asset to the tune of Rs. 583.34 crores as on 31 March 2019.

F.Y. 2020-21:

Subsequently, with the completion of other necessary works on the Commissioned section, Rs. 108.60 crore worth of Assets were added to the Rail Corridor Asset during F.Y. 2020-21. The Total Book Value of the Rail Corridor stood at Rs. 691.94 crores.

F.Y. 2021-22:

During F.Y. 2021-22, CE/Con-I/Bilaspur/ SECR vide Memorandum dated 22 June 2021, has approved the operation of Goods Trains with diesel traction on the newly constructed BG Track from Korichhapar to Dharamjaigarh (42.569 Km – 73.519 Km in length).

As on 31 December 2021, Rail Corridor Asset in the form of Property, Plant & Equipment to the tune of Rs. 950.17 crores has been created.

The movement of an asset, ‘Rail Corridor’ under the head ‘Property, Plant & Equipment since inception till 31 December 2021, is shown in the below table:

SL. NO.	DESCRIPTION	RAIL CORRIDOR ASSET	DEPRECIATION	CARRYING VALUE
1	Opening Balance as on 01-04-2019	-	-	-
2	Addition During the Year	583.34	0.19	-
3	Closing Balance as on 31-03-2020	583.34	0.19	583.16
4	Opening Balance as on 01-04-2020	583.34	0.19	583.16
5	Addition During the Year	108.59	0.65	-
6	Closing Balance as on 31-03-2021	691.94	0.84	691.10
7	Opening Balance as on 01-04-2021	691.94	0.84	691.10
8	Addition During the Period	258.83	0.57	-
9	Closing Balance as on 31-12-2021	950.17	1.41	948.76

C&AG Accounts Audit for F.Y. 2020-21

During the audit of accounts for F.Y. 2020-21 by the Comptroller and Auditor General (C&AG), the C&AG officials raised remarks on the creation of the 'Rail Corridor' asset and its method of depreciation. The Accounts Audit Memo issued by C&AG and the reply furnished by the management are as under:

Accounts Audit memo:

Balance Sheet

Note 3: Property, Plant and Equipment Rs. 70,057.46 lakh

The above includes an amount of Rs. 69,110.48 lakhs towards assets capitalized about rail corridor which includes various assets which are having significant value and should be depreciated considering separate useful life.

As per Ind AS 16, "Each part of an item of property, plant and equipment with a cost that is significant concerning the total cost of the item shall be depreciated separately". An entity allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.

Thus, it was observed that the following assets grouped under rail corridor have been depreciated considering useful life based on progressive target traffic i.e., revenue generated during the year whereas, each asset is having separate useful life and significant value and should be depreciated accordingly:

PARTICULARS	CARRYING AMOUNT AS 31.03.2021 (RS. IN LAKH)	USEFUL LIFE (IN YEARS)	DEPRECIATION AS OF 31 MARCH 2021 (RS. IN LAKH)
Bridges	13,826.17	30	643.99
Earthworks & Bridges	28,465.19	30	1,217.70
Station Building	1,749.19	30	81.47
Ballast	1,481.74	10	207.05
Sleeper	3,878.27	20	270.96
Rails	10,439.00	20	729.34
Signaling & Telecommunication works	2,096.85	9	325.56
Electrical works	7,257.95	10	1,014.18
Total	69,194.36		3,114.78

Further, Ind AS 16 also states that "A depreciation method that is based on the revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits of the asset". Therefore, management should specifically present the useful life of the asset based on its useful life and not on a revenue basis. Hence, in the books, the total depreciation has been provided amounting to Rs. 83.88 lakhs as of 31 March 2021, whereas, the depreciation should have been charged for Rs. 3114.78 lakhs. Thus, there is a short charging of depreciation by Rs. 3030.90 lakhs (Rs. 3114.78 lakhs - Rs. 83.88 lakhs).

The building has been depreciated considering useful life based on the project life whereas, the useful life should be specifically mentioned in the Accounting Policy. It was also observed that in the accounting policy, it is mentioned that the commercial operation of the company is yet to begin whereas, the commercial operations have a commercial operation date of 12 October 2019.

Thus, non-accounting of the above considering separate useful life has resulted in overstatement of Property, Plant & Equipment and profit for the period from continuing operations and understatement of Depreciation by Rs. 3030.90 lakhs.

Management Reply to Accounts Audit memo:

"The Company is a Special Purpose Vehicle constituted under the Participative Policy of Indian Railways, 2012 established for implementing the East Rail Corridor Project in the State of Chhattisgarh. The Project is being implemented based on the Joint Venture (JV) model of PPP projects under a Concession Agreement (CA) with MoR.

Pursuant to the Concession Agreement entered into between SECR and the Company, the Ministry of Railways through SECR has given the Company, the concession by way of exclusive right, license and authority to construct, operate and maintain the rail system. Under the said concession, the Company shall have the right to use the site as a sole licensee and the Company would be under a legal obligation to transfer the entire rail system to the Railways upon the termination of the Concession Agreement.

It is pertinent to mention here that the model Concession Agreement applicable in the case of SPVs derives its genesis from the BOT Model applicable for road projects. In the case of road projects created under the Build, Operate and Transfer (BOT) Model, or any other form of Public Private Partnership (PPP) route in case of road projects, Schedule II of the Companies Act, 2013 allows revenue-based amortization of the Assets i.e., Depreciation on the Asset created is based on Projected Revenue from Toll Collection till the end of the concession period. The amortisation amount or rate is such to ensure that the whole of the cost of the asset is amortised over the concession period.

Following a similar method of charging Depreciation in the case of BOT projects, the Project Assets (Rail Corridor) created by the Company (SPV) under the PPP Policy, 2012 (similar to the BOT model) depreciation has been charged on the Assets based on the Targeted NTKM to be achieved by the Company till the end of Concession Period which is 30 years at present.

In respect of charging depreciation on the Project Assets, the Company has suitably incorporated the Accounting Policy which is reproduced hereunder:

"Expenses incurred by the Company on certain activities which are essential for construction, operation and maintenance of the Rail System of the Company are recognized as Rail Corridor under Construction till Commercial Operation Date (CoD). After CoD, including Stage wise CoD, the assets are classified as Rail Corridor and depreciated/ amortised based on the Agreed Targeted Traffic based on the Concession Agreement."

Given the above, the depreciation charged by the Company to date, i.e., Rs. 83.88 lakh is in line with the applicable provisions of the Companies Act, 2013. In view of the facts stated above, the Company has noted the observations of C&AG and intends to refer the matter to C Ltd. through SE Ltd. for further directives and based on the directives received from C Ltd./SE Ltd., suitable treatment shall be carried out in the financial statements for F.Y. 2021-22.

In respect of charging depreciation on the Building (other than Project Assets), the policy of amortisation is the life of the project and the disclosure has suitably been provided in Note-3 "Property, Plant & Equipment" that the Office Building taken on an Outright basis from SIDCL is being depreciated considering the useful life of 30 years.

It is also to state that the Commercial Operation Date (COD) of the entire project is 20 September 2021. However, based on the commissioning of the 0 km - 45 Km section of the Rail Line on 12 October 2019, it is considered part commissioning of the project.

It is hereby assured that suitable changes shall be incorporated into the Accounting Policy. Because of the above submissions, this audit para may kindly be dropped."

During the Accounts Audit Meeting held between the C&AG Officials and the management on 16 June 2021, it was decided that management will take the views from the Ministry of Corporate Affairs and the Institute of Chartered Accountants of India (ICAI) through SE Ltd. /C Ltd. (holding company) for necessary treatment of depreciation on the assets about the rail corridor.

This is to state that the Scheduled Commercial Operation Date of the entire Project is now 30 September 2022.

Current Financial Year 2021-22: Observations of Statutory Auditors:

During the current financial year, M/s ABC has been appointed as the statutory auditors of the Company for F.Y. 2021-22 wherein, the statutory auditors have conducted the limited review of financial statements for the half year ended 30 September 2021. In the Limited Review Report of 30 September 2021, without qualifying the Report, the statutory auditors have highlighted the following under the head 'Other Matters' which is reproduced as under:

"1. The Company has been formed as a Special Purpose Vehicle of SE Ltd., I Ltd. and SIDC for the development of a rail corridor for the transportation of coal between the Kharsia and Dharamjaigarh districts of Chhattisgarh. As per clause 3.1.1 of the Concession Agreement entered with the Ministry of Railways (through SECR), the Company has received by way of exclusive right, license and authority to construct, operate and maintain the rail system, excluding the performance of the reserved services, for 30 (thirty) years commencing from the Appointed Date.

The said Agreement is like Service Concession Agreement as prescribed under Appendix D to Ind AS 115, 'Service Concession Arrangements'. As per Clause 17 of the said appendix, the right to construct, operate and maintain rail infrastructure should be recognized as an Intangible Asset instead of Property, Plant and Equipment and should be amortized over Targeted Traffic Method expected on Rail System over the period of the license. Further, at each year's end Management should revisit the expected traffic and make necessary adjustments so that the whole cost of rail infrastructure is amortized over the license period.

Management has assured us that the matter shall be taken up with its Holding Company, SE Ltd. and necessary changes in classification and disclosures shall be made in the financial statements of the ensuing Quarter."

Upon the remarks of the statutory auditors, the Company has gone through Appendix D to Ind AS 115. The important highlights are

Appendix D to Ind AS 115, gives specific guidance on the accounting by the operator for service concession arrangements. This Appendix applies to public-to-private service concession arrangements if

- The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price and
- The grantor controls—through ownership, beneficial entitlement or otherwise— any significant residual interest in the infrastructure at the end of the term of the arrangement.

Paragraph 11 of the said Appendix D provides treatment of the operator's rights over the infrastructure as under:

"Infrastructure within the scope of this Appendix shall not be recognized as property, plant and equipment of the operator because the contractual service arrangement does not convey the right to control the use of the public service infrastructure to the operator. The operator has access to operate the infrastructure to provide the public service on behalf of the grantor in accordance with the terms specified in the contract."

Paragraphs 14-19 of the said Appendix D provide recognition criteria of the 'construction service' provided by the Operator or Concessionaire which is being reproduced hereunder:

"The operator shall account for construction or upgrade services under Ind AS 115.

If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognized under Ind AS 115. The consideration may be rights to:

- a financial asset, or
- an intangible asset.

The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

The operator shall recognise an intangible asset to the extent that it receives a right (a license) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.

If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset, it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognized initially under Ind AS 115.

The nature of the consideration given by the grantor to the operator shall be determined by reference to the contract terms and, when it exists, relevant contract law. The nature of the consideration determines the subsequent accounting as described in paragraphs 23–26 of this Appendix. However, both types of considerations are classified as a contract asset during the construction or upgrade period in accordance with Ind AS 115."

Schedule II of the Companies Act, 2013 also allows charging depreciation (including amortisation) based on revenue method in case of intangible assets (Toll Roads) created under 'Build, Operate and Transfer', 'Build, Own, Operate and Transfer' or any other form of public-private partnership route in case of road projects. However, in the case of intangible assets under the revenue-based method, amortisation is provided based on the proportion of actual revenue earned till the end of the year to the total projected revenue from the intangible asset expected to be earned over the concession period. Total projected revenue should be reviewed at the end of each financial year and should be adjusted to reflect the changes in earlier estimates vis-à-vis the actual revenue earned till the end of the year so that the whole of the cost of the intangible asset is amortised over the concession period.

This is to reiterate that Clause 23.1 of the Concession Agreement provides that MOR shall pay to the Concessionaire (the Company) a sum equal to 50% (fifty per cent) of the revenue apportionment from freight operations on the Rail System, determined in accordance with Inter Railway Financial Adjustment Rules, as the User Fee for using the Rail System.

Query

Given the above submissions, the Company has sought the opinion of the Expert Advisory Committee of the ICAI on the following issues:

Whether the Company should continue the practice of classifying 'Rail Corriddor' under Property, Plant & Equipment and the method of depreciation based on Targeted Traffic Method expected on Rail System throughout the license.

or

as opined by C&AG during the audit of the accounts, to classify the 'Rail Corridor' into separately identifiable assets and then depreciate the individual separately identifiable assets considering the useful life of individual assets.

or

To classify the 'Rail Corridor' assets as a 'Right to Use Asset' under 'Intangible Asset' and continue the depreciation of assets based on Targeted Traffic expected on Rail System throughout the license and changing of Nomenclature from the depreciation of 'Rail Corridor' to amortisation of 'Right to Use Asset' as opined by the statutory auditor during the Limited Review Report of September 2021.

Points Considered by the Committee

The Committee notes that the basic issues raised in the query related to the accounting for the cost incurred on the Rail Corridor by the Company, particularly, the applicability of Appendix D, 'Service Concession Arrangements' to Ind AS 115, 'Revenue from Contracts with Customers' and the appropriateness of the method of depreciation/amortisation thereof. The Committee has, therefore, considered only these issues and has not considered any other issue that may arise from the Facts of the Case. Further, the Committee has examined the issue only from an accounting perspective, considering the requirements of Indian Accounting Standards (Ind ASs), notified under Companies (Indian Accounting Standards) Rules, 2015 and has not examined the legal or regulatory aspects arising from the Concession Agreement referred to by the Company.

The Committee notes the following requirements of Appendix D, 'Service Concession Arrangements' to Ind AS 115, 'Revenue from Contracts with Customers:

"2 … An arrangement within the scope of this Appendix typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period. The operator is paid for its services throughout the arrangement. The arrangement is governed by a contract that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes. Such an arrangement is often described as a 'build-operate-transfer', a 'rehabilitate-operate-transfer' or a 'public-to-private' service concession arrangement.

A feature of these service arrangements is the public service nature of the obligation undertaken by the operator. Public policy is for the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services. The service arrangement contractually obliges the operator to provide the services to the public on behalf of the public sector entity. Other common features are:

- The party that grants the service arrangement (the grantor) is a public sector entity, including a governmental body, or a private sector entity to which the responsibility for the service has been devolved
- The operator is responsible for at least some of the management of the infrastructure and related services and does not merely act as an agent on behalf of the grantor
- The contract sets the initial prices to be levied by the operator and regulates price revisions throughout the service arrangement
- The operator is obliged to hand over the infrastructure to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it.

This Appendix gives guidance on the accounting by operators for public-to-private service concession arrangements.

This Appendix applies to public-to-private service concession arrangements if:

- The grantor controls or regulates what services the operator must provide with the infrastructure, to whom it must provide them, and at what price and
- The grantor controls – through ownership, beneficial entitlement or otherwise – any significant residual interest in the infrastructure at the end of the term of the arrangement."

The Committee notes from the above that an arrangement within the scope of Appendix D to Ind AS 115 typically involves a private sector entity (an operator) constructing the infrastructure used to provide the public service or upgrading it (for example, by increasing its capacity) and operating and maintaining that infrastructure for a specified period. Further, a feature of these service arrangements is the public service nature of the obligation undertaken by the operator, i.e., the services related to the infrastructure to be provided to the public, irrespective of the identity of the party that operates the services.

In the extant case, although the Concession Agreement has been entered into between the Ministry of Railways and the Company, which is owned by Government companies, the Committee is of the view that Appendix D would still be applicable even if it is ultimately controlled by the government, as the Company is providing the services related to the infrastructure (viz., rail corridor) to be provided to the general public and is presumably acting independently and not as an agent on behalf of the grantor in respect of service concession arrangement.

The Committee notes that the Concession Agreement with the MoR contains the following key terms and conditions:

- The Company has received an exclusive right, license and authority to construct, operate and maintain the Rail System, excluding the performance of the Reserved Services, for 30 years commencing from the Appointed Date and the Concessionaire hereby accepts the Concession and agrees to implement the Project subject to and following the terms and conditions set forth herein. (Clause 3.1.1)
- The Company is obliged or entitled to:
  - Right of Way, access and license to the Site for and to the extent conferred by the provisions of this Agreement
  - Finance and construct the Rail System
  - Operate and maintain the Rail System
  - Receive the User Fee from MOR for using the Rail System or any part thereof

- Perform and fulfil all of the Concessionaire's obligations under and following this Agreement
- Bear and pay all costs, expenses and charges in connection with or incidental to the performance of the obligations of the Concessionaire under this Agreement and
- Neither assign, transfer or sublet nor create any lien or Encumbrance on this Agreement, nor the Concession hereby granted nor on the whole or any part of the Rail System nor transfer, lease or part possession thereof, save and except as expressly permitted by this Agreement or the Substitution Agreement. (Clause 3.1.3)

- The MoR is entitled to step into the project agreements, at its sole discretion, in substitution of the Company in the event of termination or suspension. (Clause 5.2.5)
- The Company shall not undertake or permit any change in ownership, except with the prior written approval of the MoR. (Clause 5.3.1)
- It is expressly agreed that the license granted hereunder shall terminate automatically and forthwith, without the need for any action to be taken by MOR to terminate the license, upon the Termination of this Agreement for any reason whatsoever. For the avoidance of doubt, the Parties expressly agree that notwithstanding any temporary or permanent structures erected on the Site by the Concessionaire or its sub-licensees, the license in respect of the Site shall automatically terminate, without any further act of the Parties, upon Termination of this Agreement. (Clause 10.2.4)
- The MoR, inter alia, undertakes to provide reasonable support and assistance to the Company provide Railway Land to the Company, undertake interconnection of the Rail System and pay User Fees to the Company. (Clause 6.1.2)
- During the construction phase, the Company shall maintain, at its cost, the existing roads along the alignment of the Rail System (Clause 12.4.1)
- The MoR shall inter alia perform the following services at the Rail System: locomotion of trains, fixing of tariff for movement and handling of any traffic of Rail System booking and delivery of Consignments deputation of necessary staff, etc. (Clause 17.1.1)
- MoR shall retain 50% of the revenue apportionment from freight operations on the Rail System on account of the cost incurred by MoR towards the provision of Reserved Services, overhead cost, central charge and all costs incidental thereto (Clause 17.1.2)
- The Company undertakes that it shall, inter alia, at all times, during the Term: make the Rail System available to MoR and the Railway Staff for the provision of Reserved Services comply with all the rules and regulations prescribed by MoR provide support and cooperation to MoR and Railway Staff. (Clause 17.6)
- In consideration of the grant of the Concession, the Company shall pay to MoR by way of a concession fee a sum of Re. 1 per annum during the Term of this Agreement. (Clause 22.1.1)
- MoR shall pay to the Company 50% of the revenue apportionment from freight operations on the Rail System. (Clause 23.1.1)
- Upon Termination on expiry of the Concession period by efflux of time, no Termination Payment shall be due and payable to the Concessionaire, provided that in the event any Project Assets, essential for the efficient, economic and safe operation of the Rail System, shall have been acquired and installed after the 15th anniversary of the COD, with the prior written consent of MoR, a Termination Payment equal to 80% of the Adjusted Depreciation Value of such Project Assets shall be made by MoR to the Company. (Clause 30.3.4)

Based on the above, the Committee notes that, under the Concession Arrangement, the MoR (the grantor) controls and regulates what services must be provided using the Rail System. The MoR also controls to whom the services must be provided using the Rail System and also determines the tariff, i.e., at what price the services are to be provided. Therefore, the criterion in paragraph 5(a) of Appendix D to Ind AS 115 is satisfied. Further, the MoR also controls a significant residual interest in the Rail System at the end of the term of the Concession Agreement. Therefore, the criterion in paragraph 5(b) of Appendix D to Ind AS 115 is also satisfied. Therefore, the Committee is of the view that Appendix D to Ind AS 115 is applicable.

The next issue relates to the classification of the consideration for the operator's construction services. In this regard, the Committee notes the following from Appendix D to Ind AS 115 and Basis for Conclusions for International Financial Reporting Standards Interpretations Committee (IFRIC) Interpretation 12, 'Service Concession Arrangements', issued by the International Accounting Standards Board:

Appendix D

"If the operator provides construction or upgrade services the consideration received or receivable by the operator shall be recognized under Ind AS 115. The consideration may be rights to:

- a financial asset, or
- an intangible asset.

The operator shall recognise a financial asset to the extent that it has an unconditional contractual right to receive cash or another financial asset from or at the direction of the grantor for the construction services the grantor has little, if any, discretion to avoid payment, usually because the agreement is enforceable by law. The operator has an unconditional right to receive cash if the grantor contractually guarantees to pay the operator (a) specified or determinable amounts or (b) the shortfall, if any, between amounts received from users of the public service and specified or determinable amounts, even if payment is contingent on the operator ensuring that the infrastructure meets specified quality or efficiency requirements.

The operator shall recognise an intangible asset to the extent that it receives a right (a license) to charge users of the public service. A right to charge users of the public service is not an unconditional right to receive cash because the amounts are contingent on the extent that the public uses the service.

If the operator is paid for the construction services partly by a financial asset and partly by an intangible asset it is necessary to account separately for each component of the operator's consideration. The consideration received or receivable for both components shall be recognized initially by Ind AS 115."

Basis for Conclusions

"BC36 The IFRIC observed that the contractual rights that the operator receives in exchange for providing construction services can take a variety of forms. They are not necessarily right to receive cash or other financial assets.

BC37 The draft interpretation proposed that the nature of the operator's asset depended on who had the primary responsibility to pay the operator for the services. The operator should recognise a financial asset when the grantor had the primary responsibility to pay the operator for the services. The operator should recognise an intangible asset in all other cases."

In the extant case, as per Clause 17.1.2, read with Clause 23.1.1 of the Concession Agreement, MoR (grantor) shall pay to the Company 50% of the revenue apportionment from freight operations on the Rail System. Thus, the Company's cash flows are dependent on the usage of the system and the grantor neither contractually guarantees to pay the operator (the Company), specified or determinable amounts nor any shortfall between amounts received from users of the public service and specified or determinable amount. Therefore, in the extant case, the Company does not have an unconditional right to receive cash or other financial asset and, accordingly, the Concession Agreement does not result in a financial asset for the Company rather, it would result in an intangible asset for the Company.

With regard to the method of amortisation used by the Company, the Committee is of the view that since the concession arrangement in the extant case results in an intangible asset for the Company, the requirements of Ind AS 38, 'Intangible Assets' in respect of amortisation shall be applicable in the extant case. In this context, the Committee notes that Ind AS 38 provides as follows:

"7AA The amortisation method specified in this Standard does not apply to an entity that opts to amortise the intangible assets arising from service concession arrangements in respect of toll roads recognized in the financial statements for the period ending immediately before the beginning of the first Ind AS reporting period as per the exception given in paragraph D22 of Appendix D to Ind AS 101."

"Useful life

88 An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or several production or similar units constituting, that useful life."

"94 The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights but may be shorter depending on the period over which the entity expects to use the asset. If the contractual or other legal rights are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.

95 There may be both economic and legal factors influencing the useful life of an intangible asset. Economic factors determine the period over which future economic benefits will be received by the entity. Legal factors may restrict the period over which the entity controls access to these benefits. The useful life is the shorter of the periods determined by these factors."

"Amortisation period and amortisation method

97 The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. … The amortisation method used shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. …

98 A variety of amortisation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. The method used is selected based on the expected pattern of consumption of the expected future economic benefits embodied in the asset and is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits.

98A There is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. The revenue generated by an activity that includes the use of an intangible asset typically reflects factors that are not directly linked to the consumption of the economic benefits embodied in the intangible asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing on how an asset is consumed. This presumption can be overcome only in the limited circumstances:

- in which the intangible asset is expressed as a measure of revenue, as described in paragraph 98C or
- when it can be demonstrated that revenue and the consumption of the economic benefits of the intangible asset are highly correlated.

98B In choosing an appropriate amortisation method under paragraph 98, an entity could determine the predominant limiting factor that is inherent in the intangible asset. For example, the contract that sets out the entity's rights over its use of an intangible asset might specify the entity's use of the intangible asset as a predetermined number of years (i.e., time), as several units produced or as a fixed total amount of revenue to be generated. Identification of such a predominant limiting factor could serve as the starting point for the identification of the appropriate basis of amortisation, but another basis may be applied if it more closely reflects the expected pattern of consumption of economic benefits.

98C In the circumstance in which the predominant limiting factor that is inherent in an intangible asset is the achievement of a revenue threshold, the revenue to be generated can be an appropriate basis for amortisation. For example, an entity could acquire a concession to explore and extract gold from a gold mine. The expiry of the contract might be based on a fixed amount of total revenue to be generated from the extraction (for example, a contract may allow the extraction of gold from the mine until total cumulative revenue from the sale of gold reaches Rs.2 billion) and not be based on time or the amount of gold extracted. In another example, the right to operate a toll road could be based on a fixed total amount of revenue to be generated from cumulative tolls charged (for example, a contract could allow the operation of the toll road until the cumulative amount of tolls generated from operating the road reaches Rs.100 million). In the case in which revenue has been established as the predominant limiting factor in the contract for the use of the intangible asset, the revenue that is to be generated might be an appropriate basis for amortising the intangible asset, provided that the contract specifies a fixed total amount of revenue to be generated on which amortisation is to be determined."

"Review of amortisation period and amortisation method

104 The amortisation period and the amortisation method for an intangible asset with a finite useful life shall be reviewed at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the amortisation period shall be changed accordingly. …"

The Committee further notes that Schedule II to the Companies Act, 2013 states the following:

"3 1[(ii) For intangible assets, the relevant Indian Accounting Standards (Ind AS) shall apply. Where a company is not required to comply with the Indian Accounting Standards (Ind AS), it shall comply with relevant Accounting Standards under Companies (Accounting Standards) Rules, 2006], except in the case of intangible assets (Toll Roads) created under 'Build, Operate and Transfer', 'Build, Own, Operate and Transfer' or any other form of public-private partnership route in case of road projects. Amortisation in such cases may be done as follows ..."

Furthermore, the Guidance Note on Accounting for Depreciation in Companies in the context of Schedule II to the Companies Act, 2013, issued by the Institute of Chartered Accountants of India (ICAI) states the following:

Intangible Assets

"42. The Ministry of Corporate Affairs (MCA), vide its notification G.S.R. 237 (E) dated 31 March 2014, made amendments to clause (ii) of paragraph 3 of Schedule II about the amortisation of intangible assets. Through the amendments, the MCA provides that revenue-based methodology 'may be' used for amortisation of intangible assets (Toll Roads) created under 'Build, Operate and Transfer'(BOT), 'Build, Own, Operate and Transfer (BOOT)' or any other form of public-private partnership (PPP) route in case of road projects.

43. The words 'may be' used in clause (ii) of paragraph 3 of Schedule II indicates that revenue-based amortisation as provided in Schedule II is optional and not mandatory. Moreover, the option is available only for intangible assets arising from toll road projects. Therefore, a company can follow a basis other than revenue-based amortisation for intangible assets arising from toll road projects. Intangible assets other than those arising from toll roads should be amortised under Accounting Standards (AS) 26, Intangible Assets, notified under the Companies (Accounting Standards) Rules, 2006."

Ind AS 101 states the following:

"D22 A first-time adopter may apply the following provisions while applying Appendix D to Ind AS 115:

(i) Subject to paragraph (ii), changes in accounting policies are accounted for under Ind AS 8, i.e. retrospectively, except for the policy adopted for amortization of intangible assets arising from service concession arrangements related to toll roads recognized in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP."

On a harmonious reading of the above requirements, the Committee notes that the option in Schedule II to the Companies Act, 2013 permitting the use of a revenue-based amortisation method for BOT road projects does not apply in the case of Ind AS compliant companies. This exception only applies to companies following Companies (Accounting Standards) Rules, 2021. However, paragraph 7AA of Ind AS 38 read with paragraph D22 of Ind AS 101 provides an exemption to a first-time adopter of Ind AS to continue with the policy adopted for amortisation of intangible assets arising from service concession arrangements related to toll roads recognized in the financial statements for the period ending immediately before the beginning of the first Ind AS financial reporting period as per the previous GAAP. The Committee is of the view that such an option under Schedule II as well as under Ind AS 101 is only applicable in the case of intangible assets arising from toll road projects and not for any other projects. Accordingly, these options cannot be extended to railway infrastructure in the extant case.

With regard to the amortisation of intangible assets in the extant case, the Committee notes the following paragraphs from the Concession Agreement:

EFFECT OF VARIATIONS IN TRAFFIC GROWTH

24.1 Effect of Variations in traffic growth on the Concession Period

24.1.1 The Parties acknowledge that the total NTKM during the Concession Period as [on the effective date] is estimated to be 123,825.88 MTKm (the "Target Traffic").

24.1.2 In the event that, as on expiry of the 25th (twenty-fifth) year after the Appointed Date the actual NTKM shall have fallen short of the Target Traffic by more than [4% (four per cent)] thereof or exceeded the Target Traffic by more than [4%] thereof, the Concession Period shall be deemed to be modified by Clause 24.2. For the avoidance of doubt, in the event of any Dispute relating to actual NTKM, the Dispute Resolution Procedures shall apply.

24. Modification in the Concession Period

24.2.1 Subject to the provisions of this Clause, in the event actual NTKM shall have fallen short of the Target Traffic, then for every 2% (two per cent) shortfall or part thereof as compared to the Target Traffic, the Concession Period shall be increased by 6(six) months or part thereof provided that such increase in Concession Period shall not, in any case, exceed 5 (five) years.

24.2.2 Subject to the provisions of Sub-clause 24.1.1 above, in the event actual NTKM shall have exceeded the Target Traffic, then for every 2% (two per cent) excess or part thereof as compared to the Target Traffic, the Concession Period shall be reduced by 6 (six) months or part thereof provided that such reduction in Concession Period shall not, in any case, exceed 5 (five) years."

The Committee notes that under Ind AS 38, there is a rebuttable presumption that an amortisation method that is based on the revenue generated by an activity that includes the use of an intangible asset is inappropriate. In the extant case, the term of the concession agreement is fixed (though in terms of a range of periods depending upon the achievement of the targeted traffic) and the Company's right to operate the rail line system is not based on a fixed total amount of revenue to be generated from tariff charged. Therefore, revenue is not established as the predominant limiting factor in the contract for the use of the intangible asset. Therefore, criterion (a) in paragraph 98A of Ind AS 38 is not met in the extant case. Criterion(b) of paragraph 98A is also not satisfied as, even in case of nil revenue in a period during the concession period due to no traffic (for example, due to maintenance work), there would still be consumption of economic benefits (the concession right) from the perspective of the Company, for example, due to efflux of time.

The Committee notes that the Company is following a depreciation policy based on the Agreed Targeted Traffic based on the Concession Agreement. The Committee notes that as per the requirement of Ind AS 38, the amortisation method is to be selected based on the expected pattern of consumption of the expected future economic benefits embodied in the asset over its useful life. Further, the useful life is influenced by both economic and legal factors and it cannot exceed the period of contractual or legal rights. In the extant case, if the Company achieves the Target Traffic before/after the originally stated concession period of 30 years, the concession period is reduced/increased as per clause 24.1 of the Concession Agreement.

The Committee notes that even though, to some extent, the length of the concession period depends upon the achievement of target traffic mentioned in the Agreement, the concession period or the period for the use of the intangible asset is not solely or primarily dependent on the traffic as the concession period (as mentioned in clause 24.2.1 and 24.2.2 of the Concession Agreement) cannot be more or less than 5 years of the total originally stated concession period of 30 years. Although the targeted traffic may extend or shorten the concession period by a maximum period of 5 years, the concession period is still fixed in terms of a range of periods and the consumption of economic benefits from the intangible asset by the Company is uniform throughout such period. For instance, if the targeted traffic is achieved in say over 20 years, still the Company has the right over the intangible asset for another 5 years. Similarly, if the targeted traffic is not achieved even after 35 years, the right over intangible assets shall not be carried beyond 35 years. Thus, although target traffic may be used as one of the factors while determining (estimating) the useful life initially and for the annual review of the remaining useful life of the intangible asset (as per paragraph 104 of Ind AS 38) in the extant case, the same cannot be considered as the sole basis of amortisation of the intangible asset.

Therefore, the Committee is of the view that the Company's current depreciation/amortisation method, which appears to be based solely on targeted traffic, is not in compliance with the requirements of Ind AS or Schedule II for the reasons mentioned above. The Company should determine and follow an appropriate amortisation method following the requirements of Ind AS 38 based on the estimated useful life of the intangible asset falling within the range of the term of the concession agreement and should be reviewed annually for any change in the useful life.

The Committee also wishes to point out that since the Company's accounting treatment in the extant case is not under the accounting treatment discussed above, the Company should rectify the same following the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' considering it as a prior period error.

Opinion

The Company's current classification of rail system infrastructure and method of depreciation/ amortisation is not in compliance with the requirements of Ind AS.

Appendix D to Ind AS 115 applies to the concession agreement with MoR for the reasons mentioned above. Under the said Appendix, the concession agreement would result in an intangible asset for the reasons mentioned above. The Company should accordingly apply the recognition and measurement requirements of the Appendix. The Company's current depreciation/amortisation method based on target traffic is not in compliance with the requirements of Ind AS or Schedule II to the Companies Act 2013. The Company should determine and follow an appropriate amortisation method under Ind AS 38.

REGULATORY UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

GUIDANCE NOTE ON AUDIT OF BANKS

The ICAI has issued the 2023 edition of the Guidance Note on Audit of Banks to deliver detailed guidance and to require the attention of statutory auditors on the latest developments. The revised 2023 edition incorporates the impact of the various circulars of the Reserve Bank of India as well as certain important advisories, and pronouncements of the ICAI which would be relevant to bank audits for the financial year ending 31 March 2023

This Guidance Note is bifurcated into two sections namely Statutory Central Audit (Section A) and Bank Branch Audit (Section B).

APPENDICES TO SECTION A OF GUIDANCE NOTE (STATUTORY CENTRAL AUDIT)

The appendices to Section A of the "Guidance Note on Bank Audit (2023): Statutory Central Audit of Banks as a whole" are as follows:

- Appendix I: Illustrative Format of Report of the Auditor on the Standalone Financial Statements of a Nationalised Bank
- Appendix II: Illustrative Format of Report of the Auditor on the Standalone Financial Statements of Banking Company
- Appendix III: Illustrative Format of Engagement Letter in Case of a Nationalised Bank
- Appendix IV: Illustrative Format of Engagement Letter in Case of a Nationalised Bank (Separate only for Audit of Internal Financial Controls Over Financial Reporting)
- Appendix V: Illustrative Format of Engagement Letter to be sent to the Appointing Authority of the Banking Company
- Appendix VI: Illustrative Format of Engagement Letter to be sent to the Appointing Authority of the Banking Company (Separate only for Audit of Internal Financial Controls over Financial Reporting under Section 143(3)(i) of Companies Act, 2013)
- Appendix VII: Illustrative Format of Management Representation Letter to be obtained from Bank Management in case of Statutory Central Audit and
- Appendix VIII: Illustrative Format of Management Representation Letter to be obtained from Bank Management in connection with the Limited Review.

APPENDICES TO SECTION B OF GUIDANCE NOTE (BRANCH AUDIT)

The Appendices to Section B of the "Guidance Note on Bank Audit (2023): Statutory Branch Audit of Banks" are as follows:

- Appendix I: Text of Section 6 of the Banking Regulation Act, 1949
- Appendix II: The Third Schedule to the Banking Regulation Act, 1949
- Appendix III: Illustrative Format of Report of the Branch Auditor of a Nationalised Bank
- Appendix IV: Illustrative Format of Report of the Branch Auditor of a Banking Company
- Appendix V: Illustrative Format of Engagement Letter to be sent to the Appointing Authority of the Nationalised Bank by Branch Auditor
- Appendix VI: Illustrative Format of Engagement Letter to be sent to the Appointing Authority of the Nationalised Bank by Branch Auditor (Separate only for Audit of Internal Financial Controls Over Financial Reporting)
- Appendix VII: Illustrative Format of Written Representation Letter to be obtained from the Branch Management
- Appendix VIII: Suggested Abbreviations Used in the Banking Industry
- Appendix IX: Illustrative Bank Branch Audit Programme for the Year ended 31/03/2023
- Appendix X: Typical reasons observed for the divergence in asset classification (large accounts) during Supervisory Cycle 2021-22 (FY 2020-21), during Capital Assessment Exercise
- Appendix XI: Advisory for Statutory Bank Branch Auditors w.r.t. Specific Considerations while conducting Distance Audit/ Remote Audit/ Online Audit of Bank Branch under current Covid-19 situation issued on 06/05/2020 and
- Appendix XII: Additional Guidance on Advances (Refer to Chapter 11 "Reporting for Advances").

IMPLEMENTATION GUIDE ON AUDIT TRAIL

The Auditing and Assurance Standards Board (AASB) of ICAI has issued an "Implementation Guide on Reporting under Rule 11(g) of the Companies (Audit and Auditors) Rules, 2014" vis a vis Audit Trail to guide the auditors to comply with this new reporting requirement.

The requirement was initially made applicable for the financial year commencing on or after the 1st day of April 2021 vide notification G.S.R. 206(E) dated 24 March 2021. However, the applicability was deferred to the financial year commencing on or after 1 April 2022, vide MCA notification G.S.R. 248(E) dated 1 April 2021.

It may be noted that a new requirement for companies has been prescribed under the proviso to Rule 3(1) of the Companies (Accounts) Rules, 2014 requiring companies, which use accounting software for maintaining their books of account, to use only such accounting software which has audit trail feature. This requirement for companies was initially made applicable for the financial year commencing on or after 1 April 2021. However, its applicability has been deferred two times and this requirement is finally applicable from 1 April 2023.

This implementation guide provides the principle-based guidance for reporting under the aforesaid rules and auditors are expected to exercise their professional judgement while reporting on such matters.

MINISTRY OF CORPORATE AFFAIRS (MCA)

MCA vide notification dated 31 March 2023, has notified Companies of Indian Accounting Standards Amendment Rules, 2023 amending the Companies (Indian Accounting Standards) Rules, 2015.

One of the significant changes is in Ind AS 1, which requires that Companies, in their financial statements, shall disclose "material accounting policy information" as against the hitherto requirement of disclosing "significant accounting policies. Accounting policy information is material if, when considered together with other information included in an entity's financial statements, it can reasonably be expected to influence decisions that the primary users of general-purpose financial statements make based on those financial statements.

Further as per the amended rules, para B14 has also been inserted in Ind AS 101, which provides 'deferred tax related to leases and decommissioning, restoration and similar liabilities'. Other than these, various other amendments have also been notified in Ind AS 102, 103, 107, 109, 115, 8, 12 and 34.

These rules shall come into force with effect from 1 April 2023.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

FRAMEWORK FOR ADOPTION OF CLOUD SERVICES BY SEBI REGULATED ENTITIES (RES)

The SEBI vide circular dated 6 March 2023, has introduced a Cloud Framework that set baseline standards for security and regulatory compliances. The main objective of the framework for the adoption of cloud services by SEBI-regulated entities (REs) is to identify and address the critical risks associated with cloud computing and to establish mandatory control measures that REs must implement before adopting cloud services.

While cloud computing offers multiple advantages viz. ready to scale, ease of deployment, no overhead of maintaining physical infrastructure etc., the REs should also be aware of the new cyber security risks and challenges which cloud computing introduces. Given the above, this cloud framework has been drafted to provide baseline standards of security and for legal and regulatory compliances by the REs. The REs includes depositories, stock brokers through exchanges, Asset Management Companies (AMCs)/mutual funds and KYC Registration Agencies (KRAs).

The cloud framework is a principle-based framework that covers Governance, Risk and Compliance (GRC), selection of Cloud Service Providers (CSPs), data ownership and data localisation, due- diligence by REs, security controls, and legal and regulatory obligations, among others.

By following the guidelines outlined in the framework, REs can establish a robust risk management approach for cloud adoption, which includes assessing risks, implementing appropriate controls, monitoring compliance, and ensuring regulatory compliance.

The framework will come into force w.e.f. 06 March 2023, for all new or proposed cloud onboarding assignments/projects of the REs.

E-WALLET INVESTMENTS IN MUTUAL FUNDS

The SEBI, vide circular dated 8 May 2017, permitted the use of e-wallet for investment in Mutual Funds within the umbrella limit of INR 50,000 for investments by an investor through both e-wallet and/or cash, per Mutual Fund per financial year. Now, SEBI clarified vide circular dated 23 March 2023, that it should be ensured that all e-wallets are fully compliant with KYC norms as prescribed by the Reserve Bank of India.

The provisions of this circular shall be applicable with effect from 1 May 2023.

MASTER CIRCULAR ON SURVEILLANCE OF SECURITIES MARKET

SEBI published Master Circular dated 23 March 2023, to ensure the availability of consolidated information contained in all the circulars about the surveillance of the securities market in one place.

This Master Circular is categorized subject-wise under various headings as follows:

- Trading rules and shareholding in dematerialized mode
- Monitoring of unauthenticated news circulated by SEBI-registered market intermediaries through various modes of communication and
- Disclosure reporting under the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015.

Further, as per this Master Circular, Registered Market Intermediaries are directed to comply with the following :

- A proper internal code of conduct and controls should be put in place.
- Employees/temporary staff/voluntary workers s etc. employed/working in the offices of market

intermediaries do not encourage or circulate rumours or unverified information obtained from the client, industry, any trade or any other sources without verification.

- Access to social media platforms/ instant messaging services/ VoIP /Blogs/Chat forums/websites/e-mail or any such medium should either be subject to controlled supervision or access should not be allowed.
- Logs for any usage of such social media platforms/ instant messaging services/ VoIP /Blogs/Chat forums/websites/e-mail or any such medium shall be treated as records and the same should be maintained as specified by the respective regulations which govern the concerned intermediary.
- Employees should be directed that any market-related news received by them either in their official mail/personal mail/blog or in any other manner, should be forwarded only after the same has been seen and approved by the Compliance Officer of the concerned Intermediaries. If an employee fails to do so, he/she shall be deemed to have violated the various provisions contained in SEBI Act and the Rules/Regulations framed there under and shall be liable for action. The Compliance Officer shall also be held liable for breach of duty in this regard.

MASTER CIRCULAR FOR PORTFOLIO MANAGERS

SEBI has issued a Master Circular dated 20 March 2023, for portfolio managers, to enable stakeholders to have access to all the applicable requirements prescribed via various circulars issued till 30 November 2022.

The circular contains procedures related to the registration and post-registration for portfolio managers.

The registration granted to a portfolio manager is for the principal office as well as for all the branch offices of the portfolio manager in India.

SEBI has formulated a Code of Advertisement governing any advertisements issued by the Portfolio Managers in connection with their activities. All Portfolio Managers registered with SEBI are required to strictly observe the Code of Advertisement set out in Annexure 2A of this Master Circular.

Further, guidelines and steps to be followed for investments by portfolio managers are stated in the circular. To ensure transparency and adequate disclosure regarding fees and charges, the client agreement shall contain a separate annexure which shall list all fees and charges payable to the portfolio manager. The said annexure shall contain details of the levy of all applicable charges on a sample portfolio of Rs.50 lacs40 over one year. The fees and charges shall be shown for 3 scenarios viz. when the portfolio value increases by 20%, decreases by 20% or remains unchanged.

All Registered Portfolio Managers are required to submit a monthly report regarding their portfolio management activity as per the format enclosed.

This master circular shall come into force from the date of its issue. However, the provisions relating to "Written down policies by Portfolio Managers" and "Fair and equitable treatment of all clients" of the Master Circular shall be applicable with effect from 1 April 2023 and the provisions relating to "Offsite Inspection data reporting to SEBI" shall come into effect from the quarter ending September 2023.

REVIEW OF TIME LIMIT FOR DISCLOSURE OF NAV OF MUTUAL FUND SCHEMES INVESTING OVERSEAS

The SEBI vide circular dated 29 March 2023, has prescribed partial modification concerning timelines for declaration of NAV depending on investment objective and asset allocation of schemes, to address the difficulties being faced in the calculation of NAV for schemes investing overseas due to differences in time zones and market hours.

(Timelines in Business days)

<table>
<tr><th>SR</th><th>SCHEME TYPE</th><th>EXISTING TIMELINE</th><th>NEW TIMELINE</th></tr>
<tr><td>1</td><td>All schemes other than those mentioned below</td><td colspan="2">11 PM on T day</td></tr>
<tr><td>2</td><td>All schemes other than those mentioned below</td><td colspan="2">9 AM on T+1 day</td></tr>
<tr><td>3</td><td>Fund of Funds (FoF) schemes</td><td colspan="2">10 AM on T+1 day</td></tr>
<tr><td>4</td><td>Schemes investing at least 80% of total assets in permissible overseas investments</td><td rowspan="2">11 PM on T day</td><td>11 PM on T day
Or
10 AM on T+1 day</td></tr>
<tr><td>5</td><td>Index funds and ETFs investing at least 80% of total assets in permissible overseas investments</td><td>10 AM on T+1 day</td></tr>
<tr><td>6</td><td>Schemes are unable to disclose NAV as per the timeline mentioned above due to the inability in capturing the same-day valuation of underlying investments</td><td>11 PM on T day
Or
10 AM on T+1 day</td><td>Such time as per disclosure made in SID along with reasons for such delayed disclosure</td></tr>
</table>

While complying with the new timelines for declaration of NAV, AMCs as a principle shall ensure that the NAV of schemes is disclosed based on the value of underlying securities/ Funds as on the T Day (i.e., date of investment in MF units in India).

The provisions of this circular shall come into force with effect from 1 July 2023.

RESERVE BANK OF INDIA (RBI)

FAQS ON DIGITAL LENDING GUIDELINES

The RBI has issued Guidelines on Digital Lending in September 2022 to regulate digital lending such as lending through online platforms and mobile apps. Now, RBI has issued FAQs on digital lending guidelines to clarify the scope and extent of application of these guidelines and address the concerns of the stakeholders in the digital lending ecosystem in India.

A few of the key clarifications have been summarized below for quick reference:

- **Definition of Digital Lending:** To avoid ambiguity in the application of these guidelines on lending transactions where certain parts are carried out through online means (such as customer acquisition, the credit assessment, approval, disbursal, etc.) and others through physical means (such as recovery), the RBI has now clarified that as long as digital technologies are largely used for digital lending, the guidelines will apply despite the presence of some physical interface with the customers.
- **Applicability on Supply Chain Financing Loans**: Since the guidelines used the term "customer" without any definitive meaning, it was not immediately clear if the term customer referred to individual customers availing personal loans or corporate customers including MSMEs availing supply chain financing solutions (such as line of credit, early payment, etc.). The RBI has now clarified that as long as the lending transaction between RE and corporate borrower (including MSME) falls within the purview of term digital lending under the guidelines, the same has to be undertaken in compliance with these guidelines.
- **Application of guidelines on EMI programs**: Other than EMI programmes on credit cards governed under the master direction on credit cards and debit cards, all loan products offered on credit cards which are not covered or envisaged under the master direction as well as all loans offered on debit cards (including EMI programmes) shall be governed by these guidelines.
- **Fund Flow**: The RBI reiterated that the flow of funds between the bank accounts of the borrower and RE in a lending transaction cannot be controlled directly or indirectly by a third party including LSP. To the relief of the industry, the RBI has allowed entities offering only payment aggregation services to facilitate loan disbursals and repayments. However, if such a payment aggregator is also performing the role of an LSP, it must comply with the guidelines and cannot provide such payment aggregation services concerning loan disbursement and repayment.
- **Collection of Cash by Recovery Agents:** The RBI has, in a bid to afford operational flexibility to the REs, clarified that REs can deploy recovery agents to recover delinquent loans in cash from the customer and thus, exempted them from the requirement of direct repayment of the loan in the RE's bank account in such situations.
- **Refund of Processing Fees**: Reasonable one-time processing fee can be retained if the customer exits the loan during the cooling-off period, subject to its upfront disclosure in KFS.

REPORTING AND ACCOUNTING OF CENTRAL GOVERNMENT TRANSACTIONS FOR MARCH 2023

RBI has issued a notification dated 16 March 2023, which states that the Government of India has decided that the date of closure of residual transactions for March 2023 be fixed as 10 April 2023.

Given the ensuing closing of Government accounts for the financial year 2022-23, receiving branches including those not situated locally, should adopt special arrangements such as courier service etc., for passing on challans/scrolls etc., to the Nodal/Focal Point branches so that all payments and collections made on behalf of Government towards the end of March are accounted for in the same financial year.

The nodal/Focal Point branches will be required to prepare a separate set of scrolls, one about March 2023 residual transactions and another for April transactions during the first 10 days of April 2023. The Nodal/Focal Point branches should also ensure that the accounts for all transactions (revenues/tax collections/payments) are affected at the receiving branches up to 31 March 2023 in the accounts for the current financial year itself and are not mixed up with the transactions of April 2023. Also, while reporting transactions of March 2023 up to 10 April 2023, the transactions of April 2023 should not be mixed up with the residual transactions relating to March 2023.

REGULATORY UPDATES

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

CIRCULAR DATED 3 MARCH 2023: MASTER CIRCULAR FOR FOREIGN VENTURE CAPITAL INVESTORS (FVCIS)

SEBI, for effective regulation of Foreign Venture Capital Investors (FVCIs) and to enable FVCIs to get access to all the applicable requirements/circulars in one place, has issued this Master Circular, which shall come into force from the date of its issue.

This Master Circular rescinds all the previous circulars/directions issued by SEBI till date and includes following contents

- FVCI is to obtain a firm commitment from its investors for the contribution of an amount of at least USD 1 million at the time of submission of applications seeking registration as FVCI.
- FVCIs are to submit the quarterly report on venture capital activity in the specified format to SEBI, within 7 days from the end of each calendar quarter.
- FVCIs must use the SEBI-introduced online system for registration applications, filing compliance reports, and any other application/reporting.

CIRCULAR DATED 8 MARCH 2023: OPERATIONAL GUIDANCE – AMENDMENT TO SEBI (BUY-BACK OF SECURITIES) REGULATIONS, 2018

Key highlights of the Circular are as follows

In case of buyback through the stock exchange route, the following restrictions have been set out

- The company shall not purchase more than 25% of the average daily trading volume (in value) of its shares or other specified securities in the 10 trading days preceding the day in which such purchases are made.
- The company shall not place bids in the pre-open market, for the first 30 minutes and the last 30 minutes of the regular trading session.
- The company's purchase order price should be within the range of ±1% of the last traded price.

Margin Requirements for Deposits in Escrow Account

- The escrow account shall consist of cash and/or other than cash.
- A portion of the escrow account other than cash shall be subjected to an appropriate haircut following the relevant SEBI circular.

NOTIFICATION DATED 14 MARCH 2023: SEBI (FOREIGN PORTFOLIO INVESTORS) (AMENDMENT) REGULATIONS, 2023 (AMENDED FPI REGULATIONS)

Key highlights of the Amended FPI Regulations are as under

- FPI must report any material changes in the information previously furnished, including the submission of any false or misleading information, to SEBI and Designated Depository Participant (DDP), maximum within 7 working days (from the existing period of 6 months).

  Note: Factors included in the material changes include a direct or indirect change in the FPIs structure or ownership or control or any direct or indirect change in the investor group.
- DDP is to further submit such information to SEBI immediately but a maximum of within 2 working days.
- The DDPs must update SEBI, depositories and stock exchanges of penalty, pending litigation/proceedings, inspections/investigations finding, for which action may have been taken or is in the process of being taken against the DDP, maximum within 2 working days.
- FPIs must ensure the maintenance of accurate details of the investor group with the DDP at all times.

NOTIFICATION DATED 27 MARCH 2023: STREAMLINING THE ONBOARDING PROCESS OF FOREIGN PORTFOLIO INVESTORS (FPIS)

SEBI previously had streamlined the onboarding process for FPIs vide SEBI (FPI) Amendment Regulations, 2023. To ease the same further, in terms of reducing registration timeline, the opening of demat, trading and bank accounts etc. SEBI has made certain modifications in the Master Circular for FPI, brief details of which are mentioned hereunder

- The DDP may grant FPI registration to the applicant based on scanned copies of the Common Application Form (CAF) and other registration-related documents which are executed by FPIs using digital signature and on the payment of applicable fees. The circular further details the step-wise process after the grant of registration.
- FPIs are allowed to use digital signatures for the execution of CAF and other registration-related documents.
- A Permanent Account Number (PAN) is verified through the CAF module available on the websites of depositories.
- DDPs/Custodians to accept the certification of copies of original documents by authorized bank officials through the SWIFT mechanism (in lieu of the physical certification) for verification of documents.
- FPI applicants, belonging to an existing FPI investor group, may submit their unique FPI investor group ID in the CAF, in place of providing complete details of all group constituents.

CIRCULAR DATED 28 MARCH 2023: NORMS FOR SCHEME OF ARRANGEMENT BY UNLISTED STOCK EXCHANGES, CLEARING CORPORATIONS AND DEPOSITORIES

In absence of any existing provision under extant law, for unlisted Market Infrastructure Institutions (MIIs) willing to undertake or involve in a scheme of the arrangement, SEBI has introduced a framework for a Scheme of Arrangement (SOA) by such unlisted MIIs, key highlights of which are mentioned hereunder

- Filing of the draft SOA with SEBI, along with a non-refundable fee for obtaining the observation letter or no-objection letter, before filing such scheme with any Court or Tribunal.

  Note: The fees should be paid at the rate of 0.1% of the paid-up share capital of the unlisted or transferee or resulting company, whichever is higher, post sanction of the proposed scheme, subject to a cap of INR 5 Lacs.
- The unlisted MII shall provide the specified list of documents/information to SEBI some of which includes draft SOA, approval of the governing board, and valuation report provided by an independent registered valuer, stating that no material event impacting the valuation has occurred during the last 6 months, a report from the Audit Committee in a specified format including specified clauses, fairness opinion on the valuation report, shareholding pattern etc.
- SEBI seeks necessary clarifications from any person relevant in this regard and shall endeavour to provide its observation letter or no-objection letter on the draft SOA within 30 days, as specified.
- The observation letter or no-objection letter of SEBI shall be valid for 6 months from the date of issuance, within which the Scheme shall be filed with any Court or Tribunal, as required, for approval.
- The provisions of this circular shall be applicable from 27 April 2023 (30 days from the date of issuance of this circular).

CIRCULARS DATED 31 MARCH 2023: EXTENSION OF COMPLIANCE PERIOD

The extant 'Operational Circular for the issue and listing of Non-Convertible Securities (NCS), Securitized Debt Instruments (SDI), Security Receipts (SR), Municipal Debt Securities and Commercial Paper (CP) dated 10 August 2021, mandates large corporates to raise a minimum of 25% of their incremental borrowings in a financial year through issuance of debt securities which must be met over a contiguous block of 2 years from Financial Year (FY) 2021-22 onwards.

SEBI, vide this circular, has extended such contiguous block of 2 years to 3 years from FY 2021-22 onwards.

31 MARCH 2023: OPERATIONAL CIRCULAR FOR DEBENTURE TRUSTEES

SEBI, for effective regulation of the Debenture Trustee and to enable the Debenture Trustee to get access to all the applicable circulars in one place, has issued this single Operational Circular, which is a chapter-wise compilation of all the applicable circulars removing inconsistencies and repetitions through consequent changes.

The provisions of this Operational Circular shall come into force with effect from 1 April 2023.

The content covered under this Operation Circular inter-alia includes the following

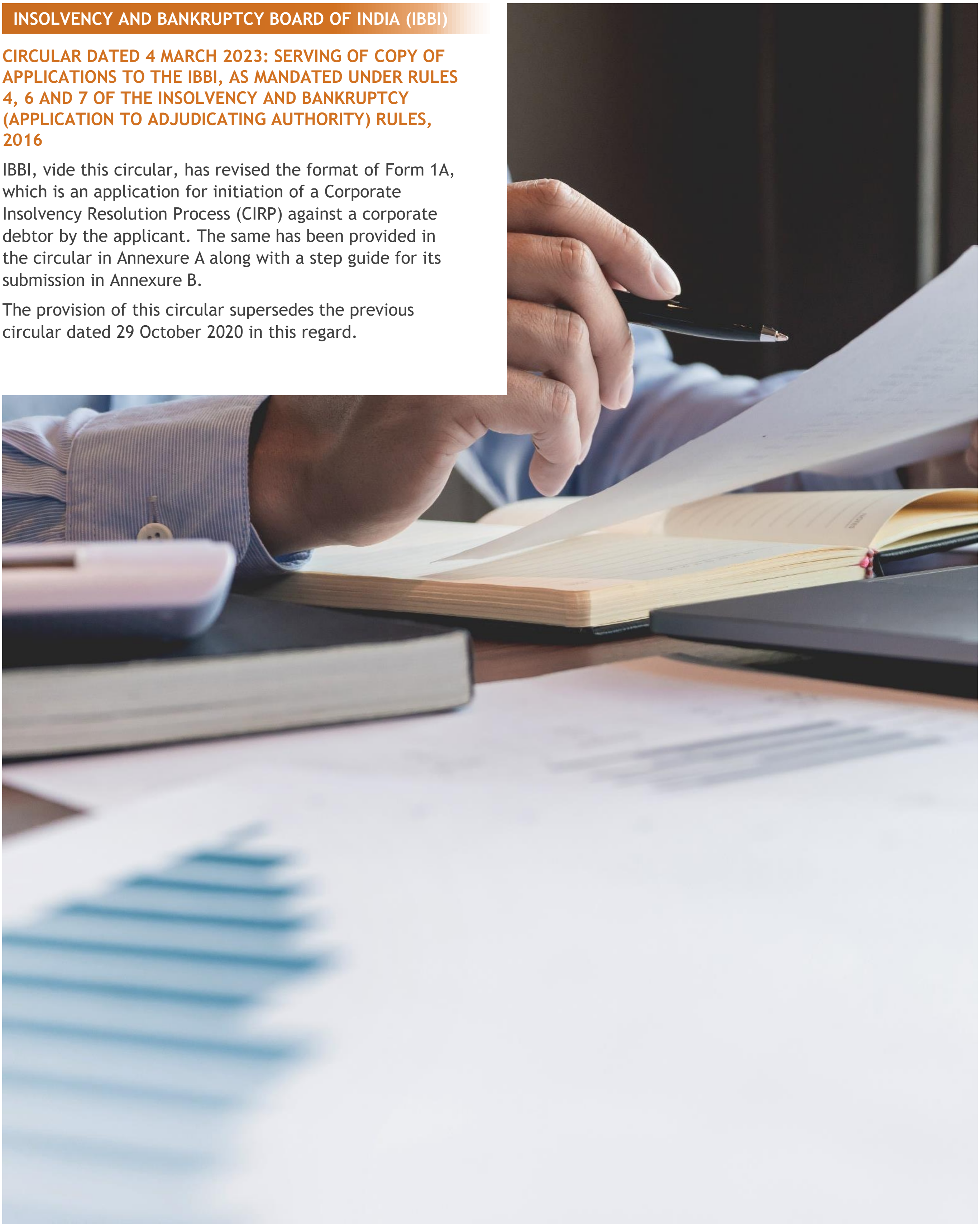
- Terms of Registration
- Due Diligence by Debenture Trustees
- Security and Covenant Monitoring System
- Recovery Expenses Fund
- Security Cover Certificate
- Periodical/ Continuous Monitoring by Debenture Trustee
- Disclosures on the website of a Debenture Trustee
- Provisions relating to Debenture Trust Deed, Sharing and Dissemination of Information by Debenture Trustee
- Redress of Investors' Grievances
- Breach of Covenants, Default and Remedies.

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (IBBI)

CIRCULAR DATED 4 MARCH 2023: SERVING OF COPY OF APPLICATIONS TO THE IBBI, AS MANDATED UNDER RULES 4, 6 AND 7 OF THE INSOLVENCY AND BANKRUPTCY (APPLICATION TO ADJUDICATING AUTHORITY) RULES, 2016

IBBI, vide this circular, has revised the format of Form 1A, which is an application for initiation of a Corporate Insolvency Resolution Process (CIRP) against a corporate debtor by the applicant. The same has been provided in the circular in Annexure A along with a step guide for its submission in Annexure B.

The provision of this circular supersedes the previous circular dated 29 October 2020 in this regard.



DIRECT TAX

CIRCULARS / NOTIFICATIONS / PRESS RELEASE

AMENDMENTS PROPOSED IN FINANCE BILL 2023

The Finance Bill 2023 was introduced by the Finance Minister in the Lok Sabha on 1 February 2023. Subsequently, on 24 March 2023, supplementary amendments to the Bill have been tabled in the Lok Sabha by notice of amendments. The revised Finance Bill 2023 has been passed in both houses and has received Presidential Assent. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/tax-alert-amendments-proposed-in-finance-bill-2023

RELAXATION FROM MANDATORY ELECTRONIC FILING OF FORM 10F EXTENDED TO A CERTAIN CATEGORY OF TAXPAYERS

The Central Board of Direct Taxes had issued a notification mandating Form 10F to be filed electronically which was subsequently relaxed for non-resident taxpayers who do not have Permanent Account Number (PAN) and are not required to have a PAN. This relaxation was till 31 March 2023 and such non-resident taxpayers were required to furnish manual Form 10F. Recently, the CBDT has issued another notification to further extend this. To read BDO India's analysis of the Budget 2023, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-further-extends-the-timeline-for-electronic-filing-of-form-10f

[Notification no. F. No. DGIT(S)-ADG(S)-3/e-Filing Notification/Forms/2023/13420, dated 28 March 2023]

JUDICIAL UPDATES

TAX DEDUCTED DOES NOT GIVE ANY CREDENCE TO THE PAYMENTS WHICH ARE IN CONTRAVENTION OF THE LAW LAID DOWN BY THE SUPREME COURT RULING IN APEX LABS

Taxpayer, a private limited company domiciled in India is engaged in the promotion, marketing, sales and distribution in India of a wide range of cardio products and related medical instruments and devices manufactured by Boston Scientific Group and also provides related post-sales support services. Its product portfolio emphasised critically important therapeutic areas such as interventional cardiology, cardiac rhythm management and electrophysiology, peripheral interventions, endoscopy, urology, and women's health. For the relevant year under consideration, the taxpayer had entered a consultancy arrangement with several doctors for providing consulting/advisory services to the taxpayer. Under this arrangement, these doctors provided the following consultancy/ advisory services to the taxpayer in lieu of consultancy fees after deducting appropriate taxes (TDS)

- Advising and assisting concerning its products
- Assistance in assessing and evaluating its latest methodologies and products
- Submitting and providing regular reports, as requested under the agreement, on taxpayer's products and methodologies

- Attend worldwide and domestic lectures or scientific meetings upon request of the taxpayer and submit written reports on such meetings
- Attend meetings with persons or parties specified by the taxpayer
- Provide training at seminars for taxpayer's employees and/or fellow healthcare professionals
- Hold lectures at meetings sponsored by the taxpayer
- Provide general advice on available technologies in the market as well as current market trends.

At the time of scrutiny, the tax officer, amongst others, disallowed the amount towards aforementioned consultancy services paid to the doctor and claimed under section 37 of the IT Act basis CBDT Circular[1] read with clause 6.8 of Medical Council of India (MCI) by holding that "any amount paid in whatever form to the doctors is not an allowable expense". Aggrieved, the taxpayer filed an appeal before the Dispute Resolution Panel which upheld the tax officer's order. Further aggrieved, the taxpayer filed an appeal before the Delhi Tax Tribunal which made the following observations while ruling in favour of the tax authorities and disallowing the payments made by the taxpayer

- Upon examining the "Invoice-Cum-Report" of various doctors which are addressed to the sales manager of the taxpayer and submissions made by the taxpayer, the consultancy expenses paid, travelling, boarding, and lodging expenses, and reimbursement to doctors are indirect ways of gifting the doctors to promote the products
- The agreement and TDS cannot give credence that the incentives received by the doctors are a deductible expense in the hands of the taxpayer
- Referring to the Supreme Court ruling in the case of M/s Apex Laboratories[2] and on perusal of the record, payments made by the taxpayer to the doctors in a different form as training and consultancy is another form devised to camouflage the real purpose.
- The deduction of tax does not give any credence or legalise the payments which are in contravention of the law laid down by the Hon'ble Supreme Court.

  [Boston Scientific India Pvt. Ltd vs. DCIT, ITA No. 871/Del/2021, (Delhi Tribunal)]

COMPOSITE CONTRACT FOR OFFSHORE SUPPLY OF EQUIPMENT NOT TAXABLE IN INDIA

Taxpayer, a non-resident company incorporated in China, is engaged in the business of supply of elevators and escalators including its design and manufacturing. Taxpayer along with its associated enterprise in India, Schindler India Private Ltd (SIPL) formed a consortium for bidding to the tender floated by Delhi Metro Rail Corporation Ltd (DMRCL) and Maharashtra Metro Rail Corporation Ltd (MMRCL) for the design, manufacturing, supply, installation, testing and commissioning of escalators. After the acceptance of bids, separate contract agreements were signed between the consortium and DMRCL, MMRCL respectively. Further, the taxpayer and SIPL had entered an MOU which was made part of both the aforesaid agreements. For the relevant year under consideration, the taxpayer treated receipt from offshore supply as business income under Article 7 of the India-China Double Taxation Avoidance Agreement (DTAA) and since it did not have any permanent establishment in India, no part of the income was offered to tax in India. The tax officer did not agree with the taxpayer's view and after considering the aforementioned agreements held as below

- The income of the taxpayer from such supply is taxable in terms of section 9(1)(i) of the IT Act
- The income of the taxpayer from India in respect of composite contracts has a significant onshore element
- Treated the consortium of the taxpayer and SIPL as an Association of Persons (AOP) and held that the contract with DMRCL and MMRCL was composite and indivisible and could not be split up into supply and commissioning parts as sought to be done by the taxpayer
- The consortium is liable to be assessed as an AOP and the income from the transaction was chargeable to tax in India, as no benefit of India-China DTAA could be afforded to AOP
- The offshore supplies have been made by the taxpayer on the Indian port of disembarkation basis and the delivery of the goods is to be taken as having been made in India.

Accordingly, the tax officer proceeded to tax 5% of the total receipts as income from composite contracts liable for tax in India. Aggrieved, the taxpayer filed a detailed objection before the Dispute Resolution Panel (DRP) which upheld the findings of the tax officer that the contracts are completely composite and proceeded to decide the issue on the basis that addition in hands of the taxpayer is on a substantive basis. Aggrieved, the taxpayer filed an appeal before the Mumbai Tax Tribunal which made the following observations while ruling in favour of the taxpayer

- On perusal of contract agreements, it is observed that the consortium shall be jointly and severally liable for undertaking the contracts. Further, the responsibility of each member of the consortium in respect of the contract is provided in the MOU entered. It states that the taxpayer and SIPL jointly bid for the project as a consortium with each party responsible for its scope of work and that both parties shall be jointly and severally responsible for completing the project
- As per the MOU, the taxpayer agreed to undertake the design, manufacturing, and supply of escalators, while SIPL's scope of work included clearance of material after reaching at port and transportation to the site as per contract conditions, installation, testing, commissioning and maintenance of escalators

[1] CBDT Circular No. 5/2012, dated 1 August 2012
[2] M/s Apex Laboratories Pvt. Ltd (SLP (Civil) No. 23207 of 2019)

- From the above, it is evident that the scope of work of each of the parties in the consortium is separately defined and since the MOU forms part of the agreement, it cannot be denied that the same is not known to DMRCL/MMRCL. Secondly, the work of SIPL can only start after the goods reach the port of destination
- The MOU also states that each party will bear its losses and retain its profits separately based on the contract price and invoices raised. It is also mentioned that separate invoices would be raised by each party on DMRCL/MMRCL for the work performed by them under the contract. The consideration shall be paid by DMRCL/MMRCL as per the terms of the contract and quoted price in respective currency to the concerned member of the consortium raising such an invoice
- In big projects, it is common practice that two or more companies with different expertise come together to form a consortium to bid for the project and jointly agree to undertake the project. In such cases, it cannot be said that the roles and responsibilities of one member can be performed by the other member. Each party is responsible for its scope of work as agreed amongst them by way of MOU and demarcated at the time of bidding for the contract. Therefore, for taxation, it is relevant to take into consideration the roles/functions performed by each member of the consortium
- The consideration received by SIPL in respect of its scope of work has already been offered for taxation in India and the same is not controverted by tax authorities
- On one hand, the tax authorities treated the agreement as a composite contract, while on other hand, no separate assessment has been made in the hands of the consortium as an AOP. For arriving at this conclusion, it heavily relied on the scope of the contract which is 'design, manufacturing, supply, installing, testing, and commissioning'
- However, the tax authorities did not consider the other parts of the contract agreement with DMRCL/MMRCL, which demarcates the description of work, the consideration, and the currency in which the same is paid. In the case of Arosan Enterprises Ltd[3], the Supreme Court held that the agreement must be read with the corresponding obligations of the parties to ascertain the true intent of the parties
- Concerning profit made by the taxpayer on a CIF basis, taking a cue from the coordinate bench ruling in the case of Siemens Aktiengesellschaft[4], the property in goods passes on to the buyer at the port of shipment
- Basis the above and further relying on the Supreme Court ruling in the case of Ishikawajma-Harima Heavy Industries Ltd[5], the taxpayer did not carry out any operations in India in respect of its scope of work. Therefore, the income earned by the taxpayer from an offshore supply of escalators and elevators is not taxable in India
- Given the aforesaid findings, the issue of non-consideration of the net loss incurred by the taxpayer is rendered academic and therefore dismissed.

  [Schindler China Elevator Company Ltd vs. ACIT, International taxation, Mumbai ITA No. 1679 and 2483/Mum/2022 (Mumbai Tax Tribunal)]

COMPLETED ASSESSMENT CANNOT BE REOPENED TO TAX THE INCOME UNDER ANOTHER SECTION AS IT AMOUNTS TO A CHANGE OF OPINION

Income is offered to tax by the taxpayer under a particular head of income/section. During the assessment, the tax officer accepts the computation of income. However, subsequently, he opines that the income should have been taxed under a different head of income/section and decides to reopen the said assessment. In such instances, a question arises as to whether this is tantamount to a change of opinion or not. In this regard, recently, the Bombay High Court had to delve into whether a completed assessment wherein the income is taxed under one section can be reopened where the tax officer is of the view that the income is taxable under another section. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-completed-assessment-cannot-be-reopened-to-tax-the-income-under-another-section-a

[Lehman Brothers Investments Pte Ltd vs. ACIT and Others (WP 2000 of 2022)]

[3] Arosan Enterprises Ltd vs. UOI [1999] 9 SCC 449 (Supreme Court)
[4] JCIT vs. Siemens Aktiengesellshaft [2009] 34 SOT 16 (Mumbai Tax Tribunal)
[5] Ishikawajma-Harima Heavy Industries Ltd vs. DIT [2007] 288 ITR 408 (Supreme Court)

INDIRECT TAX

GOODS & SERVICES TAX (GST)

JUDICIAL UPDATES

WRIT PETITION

AMENDMENT TO RULE 89(4)(C) OF THE CGST RULES RESTRICTING THE QUANTUM OF REFUND OF UNUTILISED INPUT TAX CREDIT ON ZERO-RATED SUPPLIES IS STRUCK DOWN BEING UNCONSTITUTIONAL AND VIOLATIVE OF THE PROVISIONS OF THE GST LAW

Facts of the case

- M/s. Tonbo Imaging India Pvt Ltd (Taxpayer) is engaged in the business of designing, developing, building and deploying various types of ad advanced imaging and sensor systems for various applications
- The Taxpayer exported customised imaging products between May 2018 and March 2019 (relevant period) and filed applications for a refund of unutilised Input Tax Credit (ITC) under Section 54(3)(i) of the Central Goods and Services Act, 2017 (CGST Act) read with Rule 89 of the Central Goods Services Tax Rules, 2017 (CGST Rules)
- Rule 89(4)(C) of the CGST Rules, after being amended on 23 March 2020, required the turnover of zero-rated supply of goods, to compute the amount of eligible refund, would be lower of the following:
  - Value of zero-rated supply of goods made during the relevant period without payment of tax under bond or letter of undertaking
  - Value which is 1.5 times the value of like goods domestically supplied by the same or, similarly placed supplier.
- In respect of the supplies made during the relevant period, the Taxpayer had filed refund applications on 25 May 2020, 27 May 2020 and 28 May 2020
- In respect of the aforesaid applications, three Show Cause Notices (SCNs) were issued to the Taxpayer seeking clarification for the satisfaction of the aforesaid requirements under Rule 89(4)(C) of the CGST Rules
- In response, the Taxpayer submitted that the amended rule would not apply to the instant case, as the relevant period pertains to the period prior to aforesaid the amendment of Rule 89(4)(C) of the CGST Rules
- Despite the aforesaid submissions the Tax Authority rejected the refund application, citing non-compliance of Rule 89(4)(C) of the CGST Rules
- Aggrieved by the above, the Taxpayer filed a Writ Petition before the Hon'ble Karnataka High Court challenging the validity of Rule 89(4)(C) of the CGST Rules and explanation to Rule 93 of the CGST Rules in addition to the validity of the aforesaid order passed by the Tax Authority.

Contentions by the Taxpayer

- The amendment to impugned Rule 89(4)(C) is ultra vires Section 54 of the CGST Act read with Section 16 of the Integrated Goods and Services Tax Act, 2017 (IGST Act) because the very intention of zero-rating is to make the entire supply chain of 'exports' tax-free. Consequently, the aforesaid rule whittles down the provisions of the Act and is, therefore, ultra vires the settled principle that Rules cannot override the parent legislation

- Rule 89(4)(C) of the CGST Rules is ultra vires Article 269A read with Article 246A of the Constitution of India as the Parliament has no legislative competence to levy GST on the export of goods
- It was also submitted that Rule 89(4)(C) of the CGST Rules leads to a discrimination between zero-rated supplies between two class of suppliers viz., persons opting to export under Section 16(3)(a) of the IGST Act and under Section 16(3)(b) of the IGST Act and hence, violative of Article 14 and 19(1)(g) of the Constitution of India
- It was further contended that the amended Rule 89(4)(C) of the CGST Rules is arbitrary and unreasonable since it bears no rational nexus with the objective sought to be achieved by Section 16 of the IGST Act i.e., to make the exports tax-free by 'zero-rating' them
- The amended Rule 89(4)(C) of the CGST Rules suffers from the vice of vagueness because the words 'like goods' and 'similarly placed supplier' are completely open-ended and are not defined anywhere in the GST law
- The amended Rule 89(4)(C) of the CGST Rules fails to clarify the consequences on the following:
  - If there are no goods supplied in the domestic market and value of like goods provided by other suppliers is not available
  - If a supplier who may have different pricing policy for different local customers; or
  - If the supplier prices local goods differently in different states for the same products being exported.
- Additionally, the Taxpayer also submitted that the refund applications pertain to the relevant period which is prior to 23 March 2020, and hence, the amended Rule 89(4)(C) of the CGST Rules cannot be given retrospective or retroactive effect, and consequently, the impugned order deserves to be quashed.

Contentions by the Tax Authority

- The Taxpayer failed to submit evidence that the export turnover is less than 1.5 times the value of like goods domestically supplied by them or similarly placed supplier, and hence, zero-rated turnover declared by the Taxpayer cannot be accepted for the calculation of eligible refund amount.

Observations and Ruling by the Hon'ble High Court of Karnataka

- Hon'ble High Court observed that Rule 89 of the CGST Rules contains the machinery provisions to operationalise Section 54 of the CGST Act where exports are made without payment of IGST under bond or letter of undertaking. The amendment to Rule 89(4)(C) of the CGST Rules stipulates that the turnover of zero-rated goods for computing refund of unutilised ITC on account of zero-rated supply of goods would now be restricted to a maximum quantum of 1.5 times the value of like goods domestically supplied by the same or, similarly placed supplier
- Further, the Hon'ble High Court perused the detailed write-up on 'refund of integrated tax paid on account of zero-rated supplies' issued by the Director General of Taxpayer Services, CBIC and opined that the impugned amendment to Rule 89(4)(C) of the CGST Rules is illegal, arbitrary, unreasonable, irrational, unfair, unjust and ultra vires Section 16 of the IGST Act and Section 54 of the CGST Act for the following reasons
  - Rule 89(4)(C) of the CGST Rules is ultra vires Section 54 of the CGST Act since the said rule whittles down the quantum of extent of refund allowable under Section 54 of the CGST Act
  - Rule 89(4)(C) of the CGST Rules violative of Article 14 and 19(1)(g) of the Constitution of India since it creates a hostile discrimination between zero-rated supplies between two class of suppliers viz., Section 16(3)(a) of the IGST Act and Section 16(3)(b) of the IGST Act
  - In exports, availability of rotation of funds is essential for the business to thrive and the entire concept of refund of unutilized input tax credit for exports would be obliterated where the Tax Authorities are permitted to impose a limitation or a condition taking away the exporter's right to claim refund of taxes paid on domestic procurements
  - Rule 89(4)(C) of the CGST Rules is vague as the terms 'like goods' and 'similarly placed supplier' are completely open-ended and not defined under the GST law
  - The object of zero rating would be lost if the exports are made to suffer GST as the exporter would either pass it on to the foreign recipient or would absorb it himself
  - The impugned amendment is also unreasonable and arbitrary as adequate reasoning is not present. This would make such amendment unreasonable for the reason that it bears no rational nexus with the objective sought to be achieved by Section 16 of the IGST Act.
- The Hon'ble High Court observed that terminologies, 'like goods and same or similarly placed supplier' does not have any precise meaning in the GST law and no guideline is present in that respect
- It was also observed that if the government perceives that there could be a possibility of abuse of a provision, it should adopt measures to keep a check on the same. However, the law cannot be amended on the premise of distrust without a reasonable basis
- The amendment is arbitrary and unreasonable, in as much as the possibility of taking undue benefit by inflating the value of the zero-rated supply of goods cannot be a ground to amend the rule, which deserves to be declared as invalid on this ground also

- Based on the above observations the Hon'ble High Court held that the impugned Rule 89(4)(C) of the CGST Rules is declared as ultra vires and invalid and quashed. Further, the impugned order rejecting the refund application is quashed and the Tax Authorities are directed to accept the refund application and grant a refund to the Taxpayer
- However, as regards the validity of the Explanation to Rule 93 of the CGST Rules, the same is kept open, since the Taxpayer did not press the ground.

  [High Court of Karnataka, M/s. Tonbo Imaging India Pvt Ltd vs Union of India, WP No. 13185 of 2020 [2023-VIL-198-KAR] dated 16 February 2023]

ORDERS BY AUTHORITY FOR ADVANCE RULING (AAR)

GST is not leviable on amounts recovered from employees towards canteen and transport facilities which are provided by a third party

Facts of the case

- M/s. Brandix Apparel India Private Limited (Taxpayer) is engaged in the business of manufacturing and export of apparel
- The Taxpayer has hired a third-party contractor to provide canteen services and transportation services to their employees for providing food in canteen and transportation services
- The third-party contractor raises an invoice to the Taxpayer for the provision of services, and a certain portion of the amount is recovered from the employees for availing the facility.

Questions before the AAR

- Whether GST is leviable on the amounts recovered by the Taxpayer from the employees towards canteen and transport facilities?

Contention by the Taxpayer

- As per Section 7 of the CGST Act, for a transaction to qualify as supply, it should be made in the course or furtherance of business. The term 'business' is broadly defined under Section 2(17) of the CGST Act to include various activities, whether or not for pecuniary benefit
- The submissions made by the Taxpayer, as regards the taxability of canteen facilities, are as follows:
  - The Taxpayer is engaged in the business of manufacturing apparel, and not in the business of providing canteen facilities as the same is provided as a welfare measure
  - The services supplied by the Taxpayer would not fall under the purview of the term 'supply' since the same is neither a supply of goods nor a supply of services
  - Canteen facilities provided to the employees should not be considered as an activity made in the course or furtherance of business
  - In this regard, the Taxpayer placed reliance on various rulings viz., Emcure Pharmaceuticals Ltd. *[GST-ARA-119/2019-20/B-03], Cadila Healthcare Ltd. [GUJ/GAAT/R/2022/19], Bharat Oman Refineries Ltd. [MP/AAAR/07/2021], Amneal Pharmaceuticals Pvt. Ltd. [GUJ/GAAAR/APPEAL/2021/71], Dishman Carbogen Amcis Ltd. [GUJ/GAAR/R/22/2021], Tata Motors Ltd. [GUJ/GAAAR/R/39/2021]*
  - Taxpayer has collected the canteen charges from the employees and paid the same to the canteen service provider without retaining any profit margin and it is a pure reimbursement of the employees' portion of canteen charges
  - Thus, the Taxpayer is only a mere channel in between the employees and the third-party supplier
  - The canteen facilities provided to the employees are to comply with the Factories Act, 1948 (Factories Act).
- As regards recoveries made from employees for bus facilities, the Taxpayer submitted that -
  - Amounts partially recovered from the employees for the bus facility provided is between employer and employee in due course of employment, hence the same will not be liable to be taxed under GST law
  - Further, the Taxpayer does not retain any profit element in respect of the recoveries made from the employees
  - In this regard, reliance was placed **on Tata Motors Ltd. [GST-ARA-23/2019-20/B-46], North Shore Technologies Pvt. Ltd. [Order No. 59 dated 29 June 2020 (UPAAR)] and Integrated Decisions and Systems India Pvt. Ltd. [GST-ARA-116/2019-20/B-113].**
- In view of the above, it was submitted that GST was not leviable on recoveries made by the Taxpayer for providing canteen and bus facilities to the employees.

Observations and Ruling by the AAR

- As regards the levy of GST on canteen services, the AAR held that recoveries from the employees for the canteen facilities are not leviable to GST on account of the following:
  - The Factories Act mandates the Taxpayer to provide canteen facilities to its employees
  - The canteen facilities are provided by the third party to the Taxpayer and not by the Taxpayer to its employees
  - Taxpayer is not engaged in the business of providing canteen services and hence, the canteen facility provided by the Taxpayer to its employees is not a supply in the course or furtherance of business
  - Referring to the GST Circular No. 172/04/2022 dated 6 July 2022, it was observed that the perquisites provided by the employer to the employee are in lieu of the services provided by the employee to the employer in relation to the

employment and hence, such perquisites would not be leviable to GST.

- As regards transportation facilities provided to the employees, it was concluded that recoveries made from the employees for providing such facilities are not exigible for GST due to the following reasons:
  - Taxpayer is not in the business of providing bus transportation services and hence, such facilities cannot be treated as a supply made in the course or furtherance of business
  - Transportation services are supplied by the third party to the Taxpayer and hence, the Taxpayer is the recipient of service and not the supplier of services.

[AAR- Andhra Pradesh, M/s. Brandix Apparel India Private Limited, Ruling no:02/AP/GST/2023, [2023-TIOL-48-AAR-GST] dated 21 March 2023]

EXCISE/SERVICE TAX/CUSTOMS

JUDICIAL UPDATES

SERVICES THROUGH INTERNET TO AN ENTITY LOCATED IN INDIA BY FOREIGN ENTITY DOES NOT MAKE ITS INDIAN ENTITY LIABLE TO SERVICE TAX

Facts of the case

- M/s. Dassault Systemes Simulia Pvt. Ltd. (Taxpayer) is a software dealer and an authorised dealer for M/s. DS Simulia Corp, USA (Head Office) and the sole distributor in India for Abaqus software (Software) in India. The Taxpayer purchases the software from its Head Office in the USA and enters into various types of agreements with its Indian customers, which would entitle the customer to the software and depending on the agreement's nature, also entitle to periodical updates, maintenance, and enhancement of the software
- When a purchase order was received from the customer, it forwards the same to the Head Office. Prior to May 2006, all software as well as periodical upgrades, maintenance and other activities were performed through the medium of a CD, which was imported by the Taxpayer and sold to customers in India. Post-May 2006, the sale of the software in question as well as its upgrades, maintenance, enhancement and support were done through electronic downloading only
- An audit was conducted by the Tax Authorities, basis which Show Cause Notices (SCN) were issued to the Taxpayer alleging that the maintenance service provided by the Head Office in respect of software imported by the Taxpayer falls under the category of 'management, maintenance or repair' services with effect from 10 July 2004
- Since the expenses incurred by the Taxpayer towards such services relate to the services provided by a person from a foreign country, it was inter alia alleged that the Taxpayer would be liable to pay Service tax under the Reverse Charge Mechanism (RCM) under Section 66A of the Finance Act,1994 (Finance Act) read with the Service Tax Rules, 1994 (ST Rules)
- Aggrieved by the above, the Taxpayer approached the Hon'ble Madras High Court Madras wherein the Taxpayer was directed to file a response to the above SCNs
- The Adjudicating Authority confirmed the SCNs stating that the Taxpayer was liable to pay Service tax after 18 April 2006 as the service was provided in India and the software was very much in India when the same was accessed by the customers through the internet and the extended period of limitation was also invoked
- The aforesaid order was challenged by the Taxpayer before the Appellate Authority, which upheld the aforesaid order
- Aggrieved by the above, the Taxpayer filed an appeal before the CESTAT, Chennai.

Contentions by the Taxpayer

- It was contended that no services were received by the Taxpayer and that the Taxpayer merely receives the password and website address which is promptly forwarded by the Taxpayer to its customers, who would become the owner of the software
- Thus, it is the customer who receives and uses the service of maintenance and repair and the Taxpayer merely shares the password and website address would not fall under the definition of 'management, maintenance or repair' service
- Further, even if the above service is classified under 'management, maintenance or repair' services, the liability would only arise from 1 March 2008 as the service provided through the internet from the foreign entity to the Taxpayer was specifically inserted by way of amendment to Rule 3(ii) of the Taxation of Service Rules (Provided from Outside India and Received in India), 2006 (TS Rules)
- Without prejudice to the above, it was also submitted that even if the Taxpayer was liable to discharge Service tax, the same would be an eligible CENVAT Credit, thus making the entire situation revenue neutral scenario
- The Taxpayer also contended that there was no fraud or suppression as to non-payment of Service Tax as the only allegation by the Tax Authorities is the non-declaration of expenditure incurred in foreign currency,

which is not a legal requirement under Section 73(1) of Finance Act.

Observations and Ruling of the CESTAT, Chennai

- CESTAT noted that the following are the issues to be decided:
  - Whether the Tax Authorities tax leviable under the category of 'management, maintenance or repair' service?
  - Revenue Neutrality
  - Correctness of invoking the extended period of limitation
- With respect to the issue of whether the Service tax in the present case would be leviable under the category 'management, maintenance or repair' service, CESTAT held as follows:
  - The provider of service is a foreign entity who would only upload the program on the website, provide the internet website address and a password for the same
  - On a conjoint reading of Section 66A of the Finance Act read with Rule 3 of the TS Rules, it was observed that the said provisions would apply only when the services are provided from outside India and that the said provisions would not apply where the services are provided by a person in India, to any other person in India
  - Second proviso to Rule 3(ii) of the TS Rules specifically refers to the taxable services referred in sub-clauses (zzg), (zzh) and (zzi) of section 65(105) of the Finance Act which are provided in relation to 'any goods' and the software involved in the present case is treated as 'goods'
  - It was observed that the alleged service is provided through the internet but performed in India
  - In view of the above, it was concluded that the software was available in India with the Taxpayer and hence, the provision of service was from India
  - It was also observed that there is no document placed on record to negate the Taxpayer's claim that they have not rendered any service in India and the Tax Authority has also not been able to place anything on record in their support to establish that the Taxpayer had rendered nothing but management, maintenance or repair service
  - In view of the above, it was concluded that the Taxpayer could not have been fastened with the Service tax liability under 'management, maintenance or repair' service.
- Since the Taxpayer is not leviable to pay Service tax under the reverse charge mechanism, the issue as regards revenue neutrality and invocation of an extended period of limitation has not been examined by the CESTAT.

  [CESTAT, Chennai - M/s. Dassault Systemes Simulia Pvt. Ltd. Vs CCEST, Chennai dated 24 March 2023 [2023-VIL-281-CESTAT-CHE-S]]

TRANSFER PRICING

VALUATION BY CUSTOM AUTHORITIES TO BE CONSIDERED FOR DETERMINING THE ARM'S LENGTH PRICE

The taxpayer is engaged in the manufacture of automotive iron casting and forged products. During the year under consideration, the taxpayer adopted a transaction-by-transaction approach to benchmark its international transactions. The taxpayer benchmarked the transaction of purchase of raw material, consumables, and spares under 'Other Method' by placing reliance on the valuation carried out by the Customs Officer at the time of import. The Transfer Pricing Officer (TPO) on the contrary aggregated the transaction of purchase of raw materials, consumables, and spares with the other international transactions of the taxpayer and adopted the Transactional Net Margin Method (TNMM) at an entity level. Consequently, the TPO adjusted the transaction of purchase of raw materials, consumables, and spares, which was upheld by the Dispute Resolution Panel (DRP).

In the appeal before the Hon'ble Income-tax Appellate Tribunal (Hon'ble ITAT), the taxpayer put forth the following arguments:

- Rule 10B of the Income-tax Rules, 1962 (Rules) requires that each international transaction shall be benchmarked on an independent basis
- The taxpayer has transactions with unrelated parties as well and the preparation of a reliable segmental financial statement was not possible
- The other international transactions were accepted to be at arm's length by the TPO
- While the value of the purchase of raw materials, spare parts and consumables is only Rs. 49.30 million, the adjustment made by the TPO of Rs. 375.02 million and later enhanced by the DRP to Rs. 434.73 million is disproportionate
- The international transaction of purchase of raw material, consumables and spares from related parties formed merely 1.25% of operating cost and 1.80% of total purchases of the taxpayer; and
- The value of the purchases was accepted by the revenue authorities under the Customs Rules (which use similar methods of valuation as the Income-tax).

The Hon'ble ITAT agreed with the arguments of the taxpayer. Further, the Hon'ble ITAT relied on multiple rulings wherein it was held that valuation by customs authorities is done based on scientifically formulated methods as they are responsible for making fair assessment value of the imported goods according to internationally accepted protocols and is not arbitrary. Accordingly, the Hon'ble ITAT directed the AO to adopt the valuation by the Customs Authorities and determine the arm's length price.

ACIT Vs. AT India Auto Parts Private Limited [TS-106-ITAT-2023(Bang)-TP]

TAX TRIBUNAL UPHOLDS TRANSFER PRICING ADJUSTMENT FOR CONTROL PREMIUM:

The taxpayer is engaged in investment activities and is a wholly-owned subsidiary of M/s. United Spirits Limited (USL). The taxpayer along with other group companies of USL entered into a share purchase agreement (SPA) with Relay BV (investment holding company of Diageo group) on 9, November 2012. Under the said agreement, the taxpayer sold shares of USL to Relay BV at a price which was higher than the average price at which the stocks were trading on the stock exchange (INR 1,440). The share transfer was completed on 4, July 2013 (i.e., during the given AY 2014-15) after necessary approvals were obtained. Consequently SPA, Diageo Plc. (the ultimate holding company of Relay BV) acquired a controlling interest in USL.

The TPO however was of the view that the arm's length price of the transaction of sale of shares should be determined based on the valuation of USL as a going concern and not the price at which the shares were traded on the stock exchange. The TPO conducted an independent valuation of USL by adopting the discounted cash flow method and arrived at a share value (INR 2,038.79) which was higher than that agreed upon under the SPA. Accordingly, the TPO made an adjustment, which was also upheld by the DRP.

Aggrieved with the action of the lower authorities, the taxpayer preferred an appeal before the Hon'ble ITAT on multiple grounds the significant ones being:

Applicability of Transfer Pricing Regulations

The transaction of the sale of shares was between two independent parties since Relay BV was not an Associate Enterprise (AE) of the taxpayer as of the date of the SPA and even after acquiring shares from the taxpayer. Relay BV became an AE only on 28, November 2013, after it acquired additional shares from the open market leading to its controlling stake in USL exceeding 26%.

The Hon'ble ITAT adopted a literal interpretation of Section 92A (2) of the Income-tax Act, 1961 (Act) which states that two enterprises shall be deemed to be AEs if, at any time during the previous year one enterprise holds, directly or indirectly, shares carrying not less than 26% of the voting power in the other enterprise. Accordingly, the Hon'ble ITAT ruled that for the year under consideration i.e. AY 2014-15, Relay BV was an AE.

Valuation

- The market price of the shares at the time of entering the SPA (on which the taxpayer had relied) was an appropriate mechanism.
- Relay BV had made a public offer on the same day as the SPA, in compliance with the SEBI Regulations 2011.
- Other group companies had also sold their shares to Relay BV at the same price and this approach was accepted by applying the external CUP method.
- The valuation methodology applied by the TPO does not satisfy Rule 10AB of the Income Tax Rules, 1962 (Other Method of determination of arm's length price).

The Hon'ble ITAT relied on the findings of the DRP that from the beginning Relay BV had set out a minimum target of 25.1% of the equity capital of USL to be acquired under the SPA. Therefore, Relay BV intended to exercise 25% or more of the voting rights in USL. Although the taxpayer has transferred only 3.35% of the total shares, this has contributed to and assisted Relay BV in acquiring controlling interest. In this regard, the Hon'ble ITAT placed reliance on the Ruling of the Hon'ble Supreme Court in Vodafone's case, that each share represents a vote in the management of the company and such a vote can be utilised to control the company. The taxpayer had contributed and assisted Relay BV in acquiring a controlling interest in USL along with other associates.

Hon'ble ITAT referred to the decision in the case of Lanxess India which has held that "where an assessee sold controlling interest in a company, addition on account of control premium is justified and that the mean control premium varied from 30% to 50% of the quoted price". Further, Relay BV has made an open offer to purchase 3,77,85,214 shares but only purchased 56,668 shares at a price of Rs.1,440/- per share. This explains that Relay BV was unable to purchase the full number of shares at the proposed price due to the market price being much higher at Rs.2,045.25 per share on the expiry of the tendering period (26, April 2013). Considering the above, the Hon'ble ITAT ruled that the price determined by the TPO by adopting the discounted cash flow method at INR 2,039.25 per share, which is within the aforementioned range of control premium, appears to be reasonable. Accordingly, the Hon'ble ITAT upheld the decision of the TPO and DRP.

DCIT Vs. Palmer Investment Group Ltd [TS-117-ITAT-2023(Bang)-TP]

CBDT SIGNS 95 ADVANCE PRICING AGREEMENTS IN FY 2022-23

During FY 2022-23, the Central Board of Direct Taxes (CBDT) achieved a new record by signing 95 Advance Pricing Agreements (APAs) with Indian taxpayers, which comprise 63 Unilateral APAs (UAPAs) and 32 Bilateral APAs (BAPAs). This has brought the total number of APAs signed since the beginning of the program to 516, with 420 UAPAs and 96 BAPAs.

This year has been remarkable for the CBDT as it has achieved the highest number of APA signings in any financial year since the introduction of the APA program. Additionally, it is the maximum number of BAPAs signed in any financial year to date which inter alia includes those with Finland, the UK, the US, Denmark, Singapore, and Japan.

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