ACCOUNTING, REGULATORY & TAX NEWSLETTER

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INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (“ICAI”)

EAC Opinion: Timing of capitalisation of transmission lines and sub-stations as an item of Property, Plant and Equipment from capital work-in-progress and also in case of modernisation work

Facts of the case

A Company is a registered company under the Companies Act, 1956, and is wholly owned by the State Government. The Company was formed by carving out the generation, transmission and distribution function of the erstwhile State Electricity Board. The Company is mainly vested with the functions of transmission of power in the entire State, governed by the provisions of the Electricity Act, 2003. It operates under a license issued by the State Electricity Regulatory Commission. The Company has adopted Indian Accounting Standards (Ind ASs) from 01 April 2016, onwards.

The Company is having Property, Plant and Equipment (PPE) to the tune of INR 21,619.58cr as on 31 March 2020. The assets are being procured by way of:

(a) Acquisition

(b) Purchase

(c) Gift/Consumers Contribution

(d) Construction of Transmission Lines and Sub-Stations

Sub-Stations (Plant and Machinery) and transmission lines (lines and cable network) are the major constituents of PPE of the Company. Work of construction of these sub-stations and lines is being carried out by the Company through turnkey contracts. The installation of equipment at sub-station premises and drawing of transmission lines from one station to other are being executed by turnkey contractors under the guidance and supervision of the Company’s engineers. The materials required for these works will be inspected in the works of the vendors, and then dispatch instructions are issued upon confirmation of these materials meet the technical requirements of the Company. On receipt of the materials at the site, they will be verified by the engineer-in-charge of the works for physical damages, etc.

As per section 162 of the Electricity Act 2003, the Chief Electrical Inspectorate to Government (CEIG) of the State has to inspect the premises. The main objective of the Department of Electrical Inspectorate is to ensure that all electrical installations in the State are installed and maintained as per the relevant safety codes and standards. As such, the new installations will be inspected by the Electrical Inspectorate Authorities by giving preference to ensure adherence of required safety clearances of live points from adjacent structures, from the ground and from other live points and for the safe and proper erection of equipment. This is being strictly carried out with a specific intention to avoid danger to human beings and animal life in particular and damage to the property in general. The Department is entrusted with the responsibility of ensuring the safety requirements in the generation, transmission, distribution and utilisation of electrical power.

After completion of CEIG inspection, constructed lines/stations have to be connected to the existing line/station, which requires lines clearance from the concerned Electricity Supply Company (ESCOM) and Transmission Lines and Sub-station Divisions (TL&SS Divisions). Line clearance means, for energising the newly constructed station, electrical power from an existing station which is supposed to supply power to the new station is to be interconnected. The existing station is already catering power to various stations; hence entire transmission activity in the existing station has to be temporarily diverted to other stations and keep the station idle till the equipment in the newly constructed station is connected to the existing station power source line. The entire process of the interconnection of the newly constructed station and existing station and testing requires 2 to 3 months’ time. Obtaining line clearance in large cities like Bangalore is very difficult and may require some more time. Further, pre-commissioning tests will be conducted by the Relay Testing (RT) Division of the Company to ensure proper installation including wiring of the equipment. Results of the testing are recorded in a separate register for having completed the tests.

The equipment/materials installed in the substations and transmission lines will be energised only after getting approval from the chief electrical inspectorate authorities (CEIG) and the successful completion of the pre-commissioning tests by relay testing (RT) wing of the Company. Once the erection of all the equipment is completed, the RT wing of the Company conducts pre-commissioning checks of all the equipment installed to ensure the intended performance of the equipment meeting the stipulated technical specifications and then, by extending power supply to the equipment, these will be energised and their performance will be observed by conducting stipulated tests. Load (power) will be transferred on to the new equipment by rearranging the existing network and then only, it can be said that the equipment is ‘available for use’.

After completing the interconnection works by availing line clear, the equipment will be commissioned in the presence of RT wing, the representatives of manufacturers and the contracting agency. The loads will be taken on the newly installed equipment thereafter. Once all the tests are completed and line clearance from ESCOMs is obtained and constructed stations/transmission lines are charged (energised) and technical authorities of the Company will issue an asset

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commissioned certificate for having energised the station/lines. Based on the asset commissioned certificate, the accounts section of the Company will categorise the work cost (Capital Work in Progress-CWIP) as PPE.

The Company has summarised the procedure: the assets will be constructed by the turnkey contractor > pre-commissioning test by the RT wing of the Company will be done > availability of the source line will be ensured > CEIG does the Inspection > CEIG approval will be received by the Company > Test Run > Problems rectified and again tested by RT wing of the Company > Line clearance from ESCOM will be received (for outflow of power) > Station/Line will be connected to the electricity network > Asset commissioned certificate is issued by Company's engineers.

The Company has also drawn attention to the fact that, other than the modernisation work of stations/lines, the initial capital work of construction of an asset is done mostly on requisition letters received from the respective ESCOMs. The Company recovers the cost from ESCOMs by way of tariff rates fixed by the State Electricity Regulatory Commission from time to time. After all the assets are tested and ready for operation, the same will be intimated to the concerned ESCOMs for taking the load by connecting their terminals to the Company's equipment. If the line is not connected (output of power from the concerned new assets constructed by the Company) by ESCOMs, then the Company does not wait for capitalisation/categorisation of assets as there is no fault from the Company's end.

According to the Company, as the process of commissioning involves many steps, auditors are raising objections on the timing of categorisation of assets (transferring from Capital Work in Progress to PPE Account). The audit observation from Comptroller and Auditor General (C&AG) and the reply given by the management are given below:

AE No	Inquiries	Replies
1.	MWD North Statement of Profit and Loss Expenditure Note - 31- Depreciation & Amortisation- INR 953.72cr The above includes INR 29,142,856 towards depreciation charged, on the value of four fixed assets categorized during the year 2019-20, from the date of commissioning of the asset instead of from the date of CEIG approval, which is not in order. As per paragraph 55 of Ind AS 16, the depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the Management. Based on the date of approval accorded by the Chief Electrical Inspectorate to Government (CEIG) against each work order, the transmission lines and sub-stations are charged. Hence, on the date of approval accorded by CEIG, the transmission lines and sub-stations are ready to take the load, i.e., ready to use. Accordingly, the depreciation needs to be charged from the date of approval of CEIG. A test check of assets categorized during 2019-20 revealed that in respect of four assets at Brindavan, Vidyanagar (UG cable from BIAL to Vidyanagar), Nelamangala and Tubagere, the date of commissioning was subsequent to the date of approval of CEIG. However, the depreciation was charged from the date of commissioning instead of charging the depreciation from the date of CEIG approval, from which date the asset was ready to use. Hence, charging depreciation from the date of commissioning was not in order as it resulted in short provision for depreciation amounting to INR 81.66lakh. This has resulted in an understatement of depreciation and an overstatement of Profit by INR 81.66lakh.	Sub-stations and Transmission lines after completion of construction have to be inspected and certified by the Chief Electrical Inspectorate to Government (CEIG) before commissioning of the said assets. The major objective of the inspection is to ensure safety, proper working of machinery, calibration of equipment installed, etc. A newly constructed line/station has to be connected to the existing line/station, which requires line clearance on 220 and 66kV lines/stations. Concurrence has to be obtained from the concerned ESCOM and TL&SS Division. RT division engineers have to conduct final testing on equipment before commissioning. The intention of the Management is to utilise the constructed asset in the transmission of power and to generate revenue. Hence, Certification by CEIG cannot be construed as an asset is capable of operating in the manner intended by the Management. Hence, the Audit para may kindly be dropped.

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Additional view of the Company: It is learned from the technical authorities in the field, that the CEIG is inspecting with a view to ensure safety, by verifying space clearance in respect of some equipment and height clearance in respect of transmission lines, and generally they do not carry any measurement equipment. They also verify equipment registers to ensure readings provided by the manufacturer of the equipment and reading measured by the Company's engineers at the delivery spot are tallying. Based on the above findings, the CEIG will issue an approval for commissioning the stations/transmission lines.

AE NO.	Inquiries	Replies
2.	MWD North Balance Sheet Non-current Assets Note - 3 – Capital Work-in-progress - INR 3519.23 The above includes INR 82,000,207 towards the cost of construction of 1x12.5 MVA, 66/11kV sub-station at Mandur, which was not categorised till date and is not in order. It was observed that all work relating to the construction of the sub-station was completed in 2009-10 and the capital expenditure was accounted for in August 2015. However, the work order was not closed for want of the 66kV source line from Budigere to Mandur. The work was terminated on 23 January 2017. As per paragraph 55 of Ind AS 16, the depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by the Management. Hence, as the construction of the sub-station was completed, the sub-station was ready to take the load, i.e. ready to use. Accordingly, the depreciation needs to be charged from the date of completion/ ready to use. Although the sub-station was ready to use, the same was not charged/used for want of source line and the asset was not categorised as a fixed asset till date. This has resulted in an overstatement of capital work-in-progress and understatement of fixed assets by INR 8.20cr; and understatement of Depreciation (from the date of completion of work/ ready to use) and an overstatement of profit by the same amount. The amount of depreciation to be charged from the date of completion/ready to use may be worked out and intimated to the audit.	Construction of 1x12.5 MVA, 66/11kV sub-station at Mandur, was not completed by A Limited and testing of equipment was not done. The work was terminated on 23.01.2017 by CEE, Transmission Zone, Bengaluru. Further, it is to inform that the substation work is not totally completed and in order to take the load, station work must be completed in all respects including the testing of equipment. Moreover, source line work is also pending. The station cannot be commissioned unless source line work is completed. The intention of the Management is to utilise the constructed asset in the transmission of power and to generate revenue. As such, it cannot be considered as asset is capable of operating in the manner intended by the Management. Hence, the categorization was not done for the above reason and it is requested to drop the Audit para.

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Additional view of the Company: Due to Right of way (ROW) issues, the source line to energise the station is not completed. Only on the supply of power to the station, the Company's engineers start testing equipment and make the station to cater power.

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<tr><th>AE NO.</th><th>Inquiries</th><th>Replies</th></tr>
<tr>
<td>3.</td>
<td>
MWD North
Balance Sheet
Non-current Assets
Note - 3 – Capital Work-in-progress - INR 3519.23
(a) This includes INR 450,115,659 being the expenditure incurred towards Renovation and Modernization (R&M) of 220/66/11kV receiving station at SRS Peenya which also includes the cost of erection of 150 MVA 220/66/11kV Power Transformer, which is not in order.
This work was entrusted to M/s M Electricals, Bangalore on 21 January 2014 at a cost of INR 40.98cr. A review of the progress of the above work revealed the following:
<table>
<tr><th>Sno</th><th>Nature of Work</th><th>Date of Commissioning</th></tr>
<tr><td>1</td><td>Erection of Power Transformer</td><td>12.01.2019</td></tr>
<tr><td>2</td><td>220kV South Bus (Charging)</td><td>11.10.2015</td></tr>
<tr><td>3</td><td>220kV North Bus (Charging)</td><td>11.01.2016</td></tr>
<tr><td>4</td><td>Subramanyapura Bay (Charging)</td><td>16.02.2019</td></tr>
<tr><td>5</td><td>Hoody Hebbal Line (Charging)</td><td>11.03.2019</td></tr>
<tr><td>6</td><td>Nelamangala 2 (Charging)</td><td>14.06.2019</td></tr>
<tr><td>7</td><td>Nelamangala 4,5 Bay (Charging)</td><td>31.08.2019</td></tr>
<tr><td>8</td><td>66kV Brindavan UG Cable (Charging)</td><td>18.03.2019</td></tr>
<tr><td>9</td><td>66kV Nelagadirenahalli HTLS Line (Charging)</td><td>19.03.2019</td></tr>
</table>
As per paragraph 43 of Ind AS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately. As the above works of erection of the Power Transformer and the works on 220kV sideline have been completed and charged before March 2020, the same should have been capitalized in line with Ind AS 16. Further, it was observed that the balance work to be taken up pertains to the replacement of 220kv transformer side Bay equipment and R&M works on the 66kv side.
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The Detailed Project Report (DPR) for the work of Renovation and Modernisation (R&M) works at 220/66/11kV SRS Peenya is approved on 17.02.2011.
The said work is awarded to M/s M Electricals on 02 January 2014. The target for completion of the work was 11 February 2015 revised upto 31 October 15. The Scope of the work of Renovation and Modernization includes the following:

Conversion of existing 220kV and 66kV strung bus to rigid bus formation.
Upgradation of the protection system of 220kV and 66kV side.
Installation and commissioning of additional new 220/66/11kV 100MVA Power Transformer.
Construction of 2 new 220kV line Bays and 7 new 66kV line bays for re-routing/re-alignment of 220kV Subramanyapura line and existing 66kV lines.
Dismantling of existing concrete structures at 220kV and 66kV sides.

The main objectives of the work (as per the Approved DPR) are as below:

To improve the reliability of Power supply to the surrounding areas.
To meet the future load growth.
For replacing the existing strung bus with rigid bus to minimise interruptions.
To strengthen the sub-station to meet the present load demand.
To provide numerical protection relays and bay control units conforming to IEC 61850 communication protocol with the sub-station automation system.
To provide a bus bar protection system on the 220kV system.

The existing 220/66/11kV R/s at SRS Peenya is more than 50 years old and some of the equipment have served its useful life and the spares for the same are not available. The existing RCC structure of the Main bus, Isolators, PI and other equipment at 220kV and 66kV have deteriorated. To meet the present load conditions and fault conditions, adopt the latest fast-acting protection equipment and facilitate SAS operations, the R&M works are to be carried out in different stages by availing minimum line clear/with minimum shutdown in live sub-station. The existing North, South & Auxiliary strung buses on the 220kV side have been converted to Rigid buses and also North & South strung buses of the 66kV side are to be converted to the rigid bus using aluminum tube and also the work of 66kV line side protection scheme is to be taken up. This work can only be executed by doing temporary arrangements in the sub-station and availing line clear as and when required when it needs to.
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Additional view of the Company: Due to Right of way (ROW) issues, the source line to energise the station is not completed. Only on the supply of power to the station, the Company's engineers start testing equipment and make the station to cater power.

AE NO.	Inquiries	Replies
	Non- categorisation of the above assets has resulted in an overstatement of capital work-in-progress and understatement of Property, Plant and Equipment; and an understatement of depreciation and overstatement of profit by the same amount. The component cost of the above completed works and depreciation to be charged may be worked out and intimated to the audit. (b) Further, although works on the 220kV side and most of the 66kV side and an additional 100 MVA were completed, the division capitalized IDC (Interest During Construction) of INR 23,262,507 on the opening balance, which should have been charged to revenue account. This has resulted in an overstatement of capital work-in-progress and an overstatement of profit by INR 2.33cr.	As on date, the 220k V and 66kV Side of the transformer bay equipment, such as the current transformer, Lightening arrestor, Protection system cabling & wiring, C&R Panel and integration to SAS System work is to be taken up which can be completed only after availing line clear. Further, out of 13 66kV line bay portions, only 2 Nos. bays are completed and re-routing of the lines to the new bays which is to be taken up. Only after completion of the re-routing of line work, the load can be catered to on the new bays. Also, 11 Nos. of 66kV bay work is to be taken up for which re-routing is also to be taken up, which requires line clearance and amounts to the major portion of R&M Works. Earth mat work and cable ductwork are also to be taken up for the 66kV side. To take up the replacement of bus work on the 66kV side from strung bus to rigid bus, line clear was requested several times from August 2019 to till date, but the same is not issued to take up the work. The main work which involved in the said project, such as R&M work of 220kV line bays, 220kV side was completed during the year 2019, however still 220/66/11kV Transformer bays at 220kV side and 66kV side, 66kV side bus work is to be taken up simultaneously only after approval of line clear. The station is being utilised by making use of already existing equipment. After completion and commissioning of both 220kV and 66kV side works, the station can be fully utilized and the benefits as mentioned in the DPR can be achieved. However, for achieving the benefits which are mentioned in the DPR, the following balance works are required to be carried out by availing line clears and with the proper planning, since the existing live station is having installed capacity of 3x150MVA +1x100MVA and 1x 67.5MVA totaling to 617.5MVA are feeding to the prime areas of Bengaluru Metropolitan area zone in Bengaluru: ▪ 66kV side-strung bus system to be converted to a rigid bus system. ▪ 4 Nos of 220/66/11kV Transformer bay equipment to be replaced and commissioned. ▪ Out of 13 Nos of 66kV Outgoing line bays, 2 Nos of line bays (Brindavan and Nelagadirenahalli) renovation and modernization work has been completed and the remaining 11 Nos of line bays R&M work to be taken up. ▪ Establishment of SAS for the total sub-station and to be integrated with SCADA SLDC for monitoring of real-time data. ▪ Site surfacing of the entire yard to be taken up. Due to the non-availability of line clear and due to the outbreak of COVID-19 during March 2020, the entire 220kV side work could not be completed. In order to achieve the objectives mentioned in the DPR, the total work which includes both 220kV and 66kV side has to be completed as per the DWA (Detailed Work Award) scope of the work. The intention of the management is to utilise the constructed asset in the transmission of power. As such, it cannot be considered as the said asset is capable of operating in the manner intended by the management. Hence, the categorization is not done for the above reasons. Further, as the work is under progress, the capitalisation of IDC is in order. Hence, it is requested to drop the audit para.

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Additional view of the Company: In renovation & modernisation (R&M) work, existing station equipment will be replaced by higher capacity latest and updated equipment. Though the R&M work is under progress, the station is being utilised to cater to power. In the above station, new equipment are being installed adjacent to existing equipment. Once the incoming source line work and outgoing line works are completed, new equipment will be energised; till such time, the station is made to cater to power using existing equipment. Due to the non-availability of line clearance, the completion of the above work is getting delayed inordinately. The majority of the equipment are installed and connected to an incoming source line, but the work in respect of the outgoing line is not completed due to the non-availability of line clearance.

The Company has informed that the contention of C&AG Auditors on the above three issues are:

AE No.1- Approval of the CEIG shall be considered for capitalising as PPE, as the asset is in the location and condition necessary for it to be capable of operating in the manner intended by the Management; and the asset needs to be categorised and depreciation charged from the date of approval of CEIG.

AE No.2- As station work was completed long back, the sub-station was ready to take the load, i.e., ready to use. Accordingly, the depreciation needs to be charged from the date of completion/ ready to use irrespective of the fact of a no-source power line.

AE No.3- As per paragraph 43 of Ind AS 16, each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be categorised and depreciated separately.

The contention of the Company on the above three issues are:

AE No.1- After CEIG approval, the newly constructed station needs to be energised by taking line clearance and several tests needs to be conducted to ensure proper working of the equipment and to ensure taking up the load by the station to transmit the power. On completion of the said procedure, the intention of the management to utilise the constructed asset in the transmission of power and to generate revenue is achieved and an asset commissioned certificate will be issued accordingly by the Company's engineers. Based on the asset commissioned certificate, the asset will be categorised.

AE No.2- The conclusion regarding the completion of station work can be drawn only when CEIG approval is obtained, the station energised, the equipment is tested by the Company's engineers and found that it is ready to transmit power. In this case, the station is not energised as the power source line is not completed and consequently, testing too is not done. As and when these procedures are completed, the intention of the Management to utilise the constructed asset in the transmission of power and to generate revenue is achieved and an asset commissioned certificate will be issued accordingly by the Company's engineers. Based on the asset commissioned certificate, the asset will be categorised.

AE No.3- Though a few pieces of equipment are installed and connected to the incoming line, the transmission of power cannot be carried out, as outgoing line work is under slow progress due to the non-availability of line clearance. The intention of the management to utilise the constructed asset in the transmission of power and to generate revenue is not achieved. Hence, such works cannot be categorised as assets.

The above issues have given space for more speculations as to the point that has to be considered while categorising/capitalising of an asset.

The Company acknowledges the fact that the CEIG approval is a mandatory statutory requirement to be taken by the Company before the constructed power infrastructure is connected to the grid. However at times, the CEIG has issued post-facto approval i.e. the Company has obtained the CEIG approval post connection of its power network to the grid. Hence, the Company is of the view that the CEIG approval is an administrative procedure to be adopted before formal operation is conducted. The Company also acknowledges that the sole motive of creation of new power infrastructure is to cater to the increasing power demand posed by the ESCOMs.

As there was a difference between the views of C&AG and the Company, the Company has given assurance to the C&AG to seek an opinion from the Expert Advisory Committee.

Query

In view of the above, the Company has sought the opinion of the Expert Advisory Committee (EAC) on the following issues:

- Whether the date of capitalisation (from CWIP to PPE) of an asset is the date of approval from CEIG or the date of the asset commissioned certificate.
- Can the Company capitalise an asset pending the availability of a source line though all the equipment (Plant and Machinery) in the station are installed/erected but not tested?
- Can the Company capitalise an asset pending output of power/energy from the station though all the equipment (Plant and Machinery) in the station are installed/erected, tested and CEIG approval is received?
- Whether the date of a successful test run to be adopted as the date of capitalisation of an asset.
- Whether on erection and connecting the equipment to the incoming source line, such equipment is to be categorised though transmission of power cannot be carried out.
- Whether the assets need to be capitalised when all the works mentioned in the DWA is completed by the Contractor (pending obtaining of CEIG approval and source line).
- Whether in case of modernisation work, the assets need to be capitalised on erecting of part of the assets mentioned in the DWA though the end use of transmission of power not achieved.

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Points considered by the Committee

The Committee notes that the basic issue raised in the query relates to the timing of capitalisation of transmission lines and sub-stations as an item of Property, Plant and Equipment from capital work-in-progress in case of construction as well as in case of modernisation. The Committee has, therefore, considered only this issue and has not considered any other issue. Further, the Committee has opined purely from an accounting perspective and not from any legal perspective, such as from the perspective of tariff regulations issued by the Central or State Electricity Regulatory Commission or technical aspects thereof. Further, the accounting Standards referred hereinafter are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended/revised from time to time.

At the outset, the Committee notes the following paragraphs of Ind AS 16, 'Property, Plant and Equipment':

"Property, plant and equipment are tangible items that:

(a) are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and

(b) are expected to be used during more than one period."

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

(a) it is probable that future economic benefits associated with the item will flow to the entity; and

(b) the cost of the item can be measured reliably."

"10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. …"

Subsequent costs

"12 Under the recognition principle in paragraph 7, an entity does not recognise in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognised in profit or loss as incurred. Costs of day-to-day servicing are primarily the costs of labour and consumables and may include the cost of small parts. The purpose of these expenditures is often described as for the 'repairs and maintenance' of the item of property, plant and equipment."

"15 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

16 The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

17 Examples of directly attributable costs are:

(e) costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment). Excess of net sale proceeds of items produced over the cost of testing, if any, shall not be recognised in the profit or loss but deducted from the directly attributable costs considered as part of the cost of an item of property, plant and equipment; and …"

"20 Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:

(a) costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;"

"22 The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of constructing an asset for sale (see Ind AS 2). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in self-constructing an asset is not included in the cost of the asset. Ind AS 23, Borrowing Costs, establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment."

The Committee notes from the above that an item of PPE shall be measured at cost which comprises its purchase price, any costs directly attributable to bringing the asset to the location and conditions necessary for it to be capable of operating in the manner intended by management and cost of dismantling/removing and restoring the asset. It may also be noted that cost of testing whether the asset is functioning properly is also an example of directly attributable cost. The Committee notes that the assets covered in the extant case are in the nature of self-constructed assets. Further, in terms of paragraph 22 of Ind AS 16, the cost of a self-

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constructed asset is determined using the same principles as for an acquired asset. Therefore, in the extant case, the principles for 'acquired assets' under Ind AS 16 shall be equally applicable to the self-constructed assets covered under the contract with the turnkey contractors in the extant case.

The Committee further notes from paragraph 20 of Ind AS 16 that recognition of costs in the carrying amount of an item of PPE should cease when an item is in the location and condition necessary for it to be capable of operating in the manner intended by management, even though there is a possibility of the item operating at less than full capacity. From this, the Committee is of the view that an item of capital work in progress should be transferred to the gross block of PPE when such item is in the location and condition necessary for it to be capable of operating in the manner intended by management.

The Committee now considers the issue of determining the point in time when an item is in the location and condition necessary for it to be capable of operating in the manner intended by the management. The Committee is of the view that in the case of self-constructed assets, an assessment should be made as to what event or activity characterises the point at which an asset's physical construction or installation is complete and when that asset can be considered to be in the location and condition necessary for it to be capable of operating in the manner intended by the management as per the requirements of Ind AS 16, so that all directly attributable costs incurred up to that point can be included in the cost of the self-constructed PPE and the asset can be transferred from capital work in progress to gross block of PPE.

In this context, the Committee notes from the Facts of the Case that various steps/stages are involved in the construction and installation of substations and transmission lines. As explained by the Company, after the asset is constructed by the turnkey contractor, pre-commissioning testing is undertaken by the relay testing wing of the Company and the availability of source lines is ensured. After this, an inspection is conducted by CEIG and after obtaining approval from CEIG, further testing by conducting test runs is done by the Company and identified problems are rectified by the relay testing wing of the Company. After this, line clearance is obtained from ESCOMs and station lines will be connected to the electricity network and an asset commissioned certificate is issued by the Company's engineers.

The Committee is of the view that the date or point when an asset can be considered to be in the location and condition necessary for it to be capable of operating in the manner intended by the management as per the requirements of Ind AS is a matter of technology assessment and judgement, which the Company should exercise itself in its specific facts and circumstances, considering various factors such as, technological parameters, safety parameters, various prerequisite and substantive approvals from competent authorities, completion of test runs to ensure that the asset is functioning properly, etc. In this context, the following broad guidance may be used:

- The Committee notes from the Facts of the Case that at times, CEIG has issued post-facto approval, i.e. post connection of its power network to the grid. Therefore, the Committee is of the view that in the extant case, CEIG approval may not be the sole determining factor for the determination of such date/point as discussed above. The Committee is also of the view that normally, the purpose of trial and test runs is to ensure that the asset is functioning properly, i.e., technical and physical performance (and not financial performance) of the plant/asset, as expected for its intended use, is ensured. During test/trial runs, if there are technical deficiencies/problems, adjustments are made and problems are rectified to ensure that the plant is ready for its intended use, i.e. capable of producing the intended inventories or rendering the intended services. Therefore, before such a trial/test run, the plant/asset cannot be considered to be in the location and condition necessary for it to be capable of operating in the manner intended by management as per the requirements of Ind AS 16.
- The Committee is further of the view that while determining such date or point, the manner of operation intended by the management or in other words, the intended use of acquisition or construction of an item of PPE should also be taken into consideration. Thus, after the acquisition/construction of certain equipment/PPE which are part or components of a larger and integrated PPE/ project, if these are not capable of operating due to other parts/components/facilities being under development or construction and cannot be operated independently, those equipment/ PPE cannot be considered to be in the location and condition necessary for them to be capable of operating in the manner intended by the management, as per the requirements of Ind AS 16. Conversely, if a part or component is capable of being used while construction continues on other parts, that part or component should be capitalised as PPE and depreciated accordingly, as per the requirements of Ind AS 16. However, in this context, the Committee wishes to point out that once the asset is in the location and condition necessary for it to be capable of operating in the manner intended by the management as per the requirements of Ind AS 16, if the Company is not able to operate the PPE due to non-availability of inputs or raw materials (for example, power supply in the extant case) or not able to operate at a certain level, the timing of capitalisation to PPE (i.e., transfer from CWIP) should not be delayed. In other words, the timing of capitalisation to PPE is determined based on when the asset is ready to use and not when the asset is put to use. If the asset is ready to use but not put to use due to the non-availability of power supply in the extant case, capitalisation cannot be delayed. Further, if there are any abnormal delays during the construction period, leading to the incurrence of costs of abnormal amounts of wasted material, labour, or other resources, such costs should not be included in the cost of the asset/PPE.

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The Committee also notes that Ind AS 16 lays down similar principles for major subsequent expenditure on PPE. Therefore, in the extant case, if major subsequent expenditure, viz., modernisation work meets the recognition criteria as per paragraph 7 of Ind AS 16, similar principles of recognition and measurement will be applicable as applicable in case of a self-constructed asset as discussed in earlier paragraphs. Thus, in the extant case, when the asset on which modernisation work is carried out or a component/part thereof, can be considered to be in the location and condition necessary for it to be capable of operating in the manner intended by the management as per the requirements of Ind AS 16, the same can be capitalised.

The Committee also wishes to mention that the Company should also consider the impairment of assets, if any, considering the requirements of Ind AS 36 for assets that are taking longer time to complete due to non-availability of the source line, etc.

Further with regard to the issue raised in the facts relating to the commencement of depreciation, the Committee notes paragraph 55 of Ind AS 16 as follows:

"55 Depreciation of an asset begins when it is available for use, i.e. when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with Ind AS 105 and the date that the asset is derecognised. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation, the depreciation charge can be zero while there is no production."

From the above, the Committee notes that depreciation of an asset should commence from the date the asset is available for use, i.e. when the asset is in the location and condition necessary for it to be capable of operating in the manner intended by the management. Accordingly, in the extant case, the depreciation should commence when the various assets are transferred from capital work in progress to gross block of PPE, as discussed above.

Opinion:

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

The date or point when an asset can be considered to be in the location and condition necessary for it to be capable of operating in the manner intended by the management as per the requirements of Ind AS 16 and when an item of capital work in progress can be transferred to a gross block of PPE is a matter of technological assessment and judgement, which the Company should exercise itself in its specific facts and circumstances, considering various factors such as, technological assessments, safety parameters, various pre-requisite and substantive approvals from competent authorities, etc., as discussed above. Additionally, the Company should also comply with the guidance discussed regarding impairment and commencement of depreciation based on the specific facts and circumstances.

Subject to the above overall guidance,

- (i) and (vi)The CEIG approval date or the date of the asset commissioned certificate may not be the sole determinant(s) for capitalisation of the asset. Further, regarding the implication on capitalisation pending source line see (iii) and (v) below.
- (ii) and (iv)Normally, the purpose of trial and test runs is to ensure that an asset is functioning properly, i.e., technical and physical performance (and not financial performance) of the plant/asset, as expected for its intended use, is ensured. During test/trial runs, if there are technical deficiencies/problems, adjustments are made and problems are rectified to ensure that the plant is ready for its intended use, i.e. capable of producing the intended inventories or rendering services. Therefore, before such trial/test run, the plant/asset cannot be considered to be in the location and condition necessary for it to be capable of operating in the manner intended by management as per the requirements of Ind AS 16.
- (iii) and (v) Once the asset is in the location and condition necessary for it to be capable of operating in the manner intended by the management as per the requirements of Ind AS 16, just because the Company is not able to operate the PPE due to non-availability of inputs or raw materials (for example, power supply in the extant case) or not able to operate at a certain level, the timing of capitalisation to PPE (i.e., transfer from CWIP) should not be delayed. In other words, the timing of capitalisation to PPE is determined based on when the asset is ready to use and not when the asset is put to use. If the asset is ready to use but not put to use due to non-availability of power supply in the extant case, capitalisation cannot be delayed.
- (vii)In case of modernisation work, when the asset on which modernisation work is carried out or a component/part thereof, can be considered to be in the location and condition necessary for it to be capable of operating in the manner intended by the management as per the requirements of Ind AS 16, the same should be capitalised, as discussed above.

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SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Review of provisions pertaining to specifications related to International Securities Identification Number (ISIN) for debt securities issued on private placement basis

The SEBI has issued the circular dated 31 October 2022 to revise the provisions pertaining to specifications related to ISIN for debt securities issued on a private placement basis by modifying the Operational Circular for the issue and listing of Non-Convertible Securities (NCS), Securitised Debt Instruments (SDI), Security Receipts (SR), Municipal Debt Securities and Commercial Paper (CP) dated 10 August 2021 as amended from time to time (Operational Circular).

With an aim to boost liquidity in the corporate bond market, it has been decided to further cap the number of ISINs maturing in a financial year for debt securities issued on private placement. The ISIN (International Securities Identification Number) code, which has 12 characters, is used for identifying securities like stocks, bonds, warrants and commercial papers.

With respect to a private placement of debt securities, SEBI said that a maximum number of 14 ISINs maturing in any financial year will be allowed for an issuer of debt securities.

It has also decided to put a cap of six ISINs for the capital gains tax debt securities by the authorised issuers under the Income Tax Act. The current limit is 12.

Of the 14 ISINs maturing in a financial year, a maximum of nine ISINs maturing per financial year will be allowed for plain vanilla debt securities. Within this limit of nine ISINs, the issuer can issue both secured and unsecured debt securities.

In case the total outstanding amount across the 9 ISINs, maturing in a given financial year, reaches INR 15,000 crore then 3 additional ISINs would be permitted to mature in the same financial year. The same should be intimated by the issuer to the stock exchanges and depositories.

A maximum of 5 ISINs maturing per financial year shall be allowed for structured debt securities and market-linked debt securities. Where an issuer issues only structured/market-linked debt securities, the maximum number of ISINs allowed to mature in a financial year shall be 9. These thresholds may be reviewed periodically to further reduce fragmentation in the corporate bond market.

The provisions of this circular shall be applicable to ISINs used to issue debt securities from 01 April 2023. The newly capped limits would not be applicable to ISINs utilised for the issuance of debt securities up to 31 March 2023 and maturing in later years.

Framework to address the ‘technical glitches’ in Stock Brokers’ Electronic Trading Systems

The SEBI vide circular dated November 25, 2022, has issued a new framework to address the ‘technical glitches’ being faced by Stock Brokers in India.

In the wake of a growing number of such incidents, SEBI constituted a working group to recommend suitable measures to address the issue. Based on the recommendations of the working group and views obtained from stakeholders & industry experts, it has been decided to put in place the framework to deal with technical glitches.

This circular which will come into effect from 01 April 2023, addresses a number of factors including new reporting requirements, capacity planning, software testing and change management, monitoring mechanism, Business Continuity Planning (BCP) and Disaster Recovery Site (DRS).

‘Technical glitch’ has been defined in the circular as any malfunction in the systems of the stock broker including malfunction in its hardware, software, networks, processes or any products or services provided by the stock broker in the electronic form. The malfunction can be on account of inadequate Infrastructure/systems, cyber-attacks/incidents, procedural errors and omissions, or process failures.

In terms of the reporting requirements, Stock brokers shall inform about the technical glitch to the stock exchanges immediately but not later than 1 hour from the time of occurrence of the glitch. Additionally, the stock brokers will have to submit a Preliminary Incident Report to the Exchange within T+1 day of the incident (T being the date of the incident). The report shall include the date and time of the incident, the details of the incident, the effect of the incident and the immediate action taken to rectify the problem.

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Most importantly, the stock brokers will have to make a Root Cause Analysis (including details of time, cause, duration of glitch, the chronology of events, etc.) and submit the same to the exchanges within 14 days.

Timelines for transfer of dividend and redemption proceeds to unitholders

The SEBI has issued a circular dated 25 November 2022 to amend Regulation 53 of the SEBI (Mutual Funds) Regulations, 1996.

SEBI has reduced the timeline for dividends payout to 7 working days from the current 15 days. The record date would be 2 working days from the issue of a public notice, wherever applicable, for the purpose of payment of dividend. The payment of dividends to the unitholders shall be made within 7 working days from the record date.

It has further reduced the timeline for redemption payout to 3 working days from the existing 10 working days. The transfer of redemption or repurchase proceeds to the unitholders shall be made within 3working days from the date of redemption or repurchase.

For schemes investing at least 80%of total assets in such permissible overseas investments, the transfer of redemption or repurchase proceeds to the unitholders would be made within 5 working days from the date of redemption or repurchase.

It was clarified that Interest for the period of delay in transfer of redemption or repurchase or dividend shall be payable to unitholders at the rate of 15% per annum along with the proceeds of redemption or repurchase or dividend. Such interest would be borne by AMCs and the details of such payments would be sent to SEBI as part of Compliance Test Reports.

In consultation with SEBI, the industry body Association of Mutual Funds in India (AMFI) would publish a list of exceptional circumstances for schemes unable to transfer redemption or repurchase proceeds to investors within the prescribed time, along with the applicable time frame for the transfer of redemption or repurchase proceeds to the unitholders in such exceptional circumstances. The list would be published within 30 days.

Reporting of trades in Non-convertible Securities under SEBI (Issue and Listing of Non-Convertible Securities) Regulations, 2021 (NCS Regulations)

The SEBI has issued a circular dated 24 November 2022 to amend the Operational Circular dated 10 August 2021 which prescribed requirements pertaining to operational and other aspects relating to the issue and listing of Non-convertible Securities.

In the said Operational Circular, Chapter XVI on ‘Reporting of Trades’, inter alia, contains provisions relating to reporting, clearing and settlement of OTC trades by all person(s) dealing in non-convertible securities.

It is observed that information on OTC trades in listed Non-convertible Securities provided to the Stock Exchange(s) by the investors is incomplete and/ or inaccurate. This, in turn, amounts to incorrect and distorted information being displayed on the Stock Exchanges’ websites.

Accordingly, paragraph 1.3 of chapter XVI of the said circular now states that the reporting of OTC trades in non-convertible securities shall be made by all person(s) dealing in such securities irrespective of whether they are SEBI registered intermediaries or otherwise in the prescribed format.

Stock Exchanges shall monitor the compliance of this circular / chapter XVI of the Operational circular and bring to the notice of SEBI, periodically, discrepancies in reporting of OTC trades by investors.

This circular shall be applicable with effect from 01 January 2023.

Disclosures and compliance requirements for Issuance and Listing of Municipal Debt Securities under SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015, which fall within the definition of “green debt security”

The SEBI vide circular dated 24 November 2022 has provided clarification regarding the issue of ‘green debt security’ by an issuer under SEBI (Issue and Listing of Municipal Debt Securities) Regulations, 2015(‘ILMDS Regulations’).

SEBI has received representations from market participants on the compliances an issuer under the ILMDS Regulations would have to undertake in case it is desirous of issuing green debt security, in the absence of similar provisions in the ILMDS Regulations.

Accordingly, an issuer under the ILMDS Regulations may issue a green debt security if it falls within the definition of “green debt security”, as per Regulation 2(1)(q) of the NCS Regulations. Such issuer, shall, in addition to the requirements prescribed under the ILMDS Regulations and circulars issued there under, comply with the provisions for ‘green debt security’, as specified under the NCS Regulations and circulars issued thereunder.

This circular shall be applicable with immediate effect.

Notification dated 09 November 2022: SEBI (Infrastructure Investment Trusts)

(Second Amendment) Regulations, 2022 (Amended InvIT Regulations)

The Amended InvIT Regulations (effective 01 January 2023) inter-alia provides for the following:

- No InvIT shall make a Private Placement (PP) of units of InvITs that are not listed and accordingly, all the provisions in relation to this are now omitted.
- The requirement of applying for delisting of units of InvIT in a case where the privately placed and listed

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InvIT chooses to convert into a privately placed unlisted InvIT and all the compliance requirements associated with it are done away with.

- The Chapter pertaining to 'Framework for PP of units of InvITs which are not listed' shall no longer apply to InvIT which propose to issue units.

Notification dated 09 November 2022: SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2022 (Amended REIT Regulations)

The Amended REIT Regulations provide for the following:

- A minimum number of total units of REIT to be held by sponsor(s) and the sponsor group(s) for a period of three years from the date of listing of such units pursuant to the initial offer on a post-issue basis, has been decreased from 20% to 15%.
- The sponsor(s) and the sponsor group(s) shall continue to be liable to the REIT, trustees and unit holders for all acts of commission or omission, representation or covenants related to the formation of the REIT and the sale or transfer of assets or holding company or Special Purpose Vehicle to the REIT.

Circular dated 09 November 2022: SEBI (Payment of Fees) (Amendment) Regulations, 2022 (Amended Fees Regulations)

The Amended Fees Regulations, which are into force with effect from 01 November 2022, provide for the following:

- Payment and collection of fees applicable to Foreign Portfolio Investors (FPI)
  - Category I and II FPI are now required to pay registration fees of USD 2500 (as against USD 3,000) and USD 250 (as against USD 300) respectively at the time of submission of the form to the designated depository participant.
  - FPI shall collect the regulatory fee of USD 800 (as against USD 1,000) from every subscriber of the offshore derivative instrument issued by it and deposit the same in the designated bank account of the Board by way of electronic transfer.
- Payment of fees applicable to Foreign Venture Capital Investors (FVCI) - The application and registration fees for the purpose of seeking registration of FVCI are now reduced to USD 2,100 (as against USD 2,500) and USD 8,500 (as against USD 10,000) respectively.

Notification dated 09 November 2022: SEBI (Substantial Acquisition of Shares and Takeovers) (Amendment) Regulations, 2022 (Amended Takeover Regulations)

Key highlights of the Amended Takeover Regulations are as under:

According to the extant framework, in the case of the acquisition of shares/voting rights/control over the target company, the offer price determined shall be the highest of four parameters defined, one of which pertains to the calculation of the price basis the volume-weighted average market price of 60 days trading volume. The Amended Takeover Regulations exempt the applicability of this requirement in case of disinvestment of a public sector undertaking resulting in a change in control.

Further, the provision pertaining to 'completion of acquisition' is amended to include, in addition to cash consideration, the provision of unconditional and irrevocable bank guarantee issued in favour of the manager to the open offer by any scheduled commercial bank, subject to the approval of the Reserve Bank of India.

Notification dated 09 November 2022: SEBI (Issue and Listing of Non-Convertible Securities) (Second Amendment) Regulations, 2022 (Amended NCS Regulations)

And

Circular dated 14 November 2022: Registration and regulatory framework for Online Bond Platform Providers (OBPP Circular)

To streamline the operations of OBPPs and to facilitate the participation of investors in the bond market, SEBI has introduced a regulatory framework for the working of such OBPPs by inserting new Regulation 51A vide an Amended NCS Regulations.

Key highlights of the OBPP circular (which is applicable with immediate effect) read with Amended NCS Regulations are as under:

- An entity desirous of operating as an OBPP shall be a company incorporated in India and register itself as a stockbroker in the debt segment of the Stock Exchange(s) as specified under NCS Regulations.
- An application for registration must include the specified requirements or provide necessary confirmations/undertakings in relation to:
  - Roles and obligations,
  - Technology,
  - Operating framework,
  - Compliance with minimum disclosure requirements in a specified manner,
  - Disclosure of conflict of interest,
  - Advertisement,
  - Investor grievance redress mechanism,
  - Risk management
  - Handling exigencies
  - Data integrity
  - Reporting and disclosure requirements
- A person acting as an OBPP without the certificate of registration or prior to the date of Amended NCS Regulations coming into force, may continue to do so for a period of three months from the date of Amended NCS

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Regulations coming into force or if it has made an application within the specified period, till the disposal of such application by the Board.

- An entity acting as an OBPP on or prior to this circular coming into force shall offer only the listed debt securities and debt securities proposed to be listed through a public offering

Circular dated 10 November 2022: Applicability of Goods & Services Tax (GST) on fees remitted to SEBI

SEBI vide its previous circular with respect to 'Levy of GST on the fees payable to SEBI informed Market Infrastructure Institutions, SEBI registered intermediaries and companies which have listed/are intending to list their securities on the Stock Exchange(s) and persons who are dealing in the securities market, that the fees/other charges payable to SEBI are subject to GST at the rate of 18% w.e.f. 18 July 2022.

Accordingly, SEBI, vide this circular, amends Chapter XX of the Operational Circular for the issue and listing of NCS, Securitised Debt Instruments, Security Receipts, Municipal Debt Securities and Commercial Paper providing that remittance particulars to be submitted to SEBI in a format specified therein and the same be informed by email as well at the address od-ddhs@sebi.gov.in.

Notification dated 14 November 2022: SEBI (Listing Obligations and Disclosure Requirements) (Sixth Amendment) Regulations, 2022 (Amended LODR Regulations)

Key highlights of Amended LODR Regulations are as under:

- In case of appointment or removal of an independent director where a special resolution fails to get passed, but votes cast in favour exceed the votes cast against the resolution, then such appointment or removal shall be deemed to have been made.
- Not only in the case of public issues or a rights issue but also in case of preferential issues or qualified institutions placement, the listed entity is required to submit any comments/report received from the monitoring agency (appointed to monitor utilisation of proceeds of above-mentioned issues) to the stock exchange(s) within the given timeline.
- Listed entities are required to submit unaudited or audited quarterly and year-to-date standalone financial results on a quarterly basis to recognised stock exchange within 45 days from the end of the quarter, other than last quarter. SEBI has now directed that, for the last quarter, the listed entity shall submit unaudited or audited quarterly and year-to-date standalone financial results within 60 days from the end of the quarter to the recognised stock exchange(s).
- The issuers, required to be audited by the Comptroller and Auditor General of India (CAG) must submit to the stock exchanges:
  - unaudited financial results along with a limited review report from the CAG, an auditor designated by the CAG, or a practicing-chartered accountant within 60 days of the end of the financial year and
  - audited financial results within 9 months of the financial year.
- The requirement of submitting, a statement of assets and liabilities and statement of cash flows (documents) as part of its standalone or consolidated financial results for the half year is done away with. Instead, a new requirement of submitting documents at the end of every half year, by way of a note, along with the financial results is inserted.
- The line items, to be disclosed, while submitting quarterly and annual financial results are revised.
- The provisions/framework with respect to Scheme of Arrangement by the listed entity having listed its Non-Convertible Debt Securities (NCDs) or Non-Convertible Redeemable Preference Shares (NCRPS) along with its fee schedule is added.

Notification dated 15 November 2022: SEBI (Alternative Investment Funds) (Fourth Amendment) Regulations, 2022 (Amended AIF Regulations)

Key highlights of the Amended AIF Regulations are as under:

- The meaning of 'tenure' for the purpose of definition of 'investible funds' is the duration of scheme from the date of first close till the last date of the term as specified in the fund documents.
- The clause 'investment conditions and restrictions of schemes of AIF is amended to state that
  - the first close of the scheme shall be declared by an AIF in the Board specified manner failing which an AIF shall be required to file a fresh application for the launch of the scheme by paying prescribed scheme fees.
  - the manner of calculating the tenure (including modification of tenure) of a close-ended scheme of an AIF is to be specified by the Board from time to time.
- Prior approval of the Board is required in case of a change of Sponsor or Manager, or change in control of the AIF, Sponsor or Manager, subject to prescribed fees and conditions.
- The Manager and the trustee/the trustee company or the Board of Directors or designated partners of the AIF to ensure that the assets & liabilities and banks & securities accounts of each AIF scheme are segregated and ring-fenced from other schemes.

Circular dated 17 November 2022: Guidelines for AIF for declaration of the first close, calculation of tenure and change/change in control of sponsor/manager

The circular shall come into force with immediate effect, the key highlights of which are as under:

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The timeline for the First Close of the scheme shall be declared by an AIF in the manner specified here under:

- The First Close of a scheme shall be declared within 12 months from the date of the Board's communication for taking the PP Memorandum of the scheme on record.
- In case of open-ended schemes of Category III AIFs, the First Close shall refer to the close of the Initial Offer Period.
- The First Close of the Large Value Fund for Accredited Investors (LVF) scheme shall be declared within 12 months from the date of grant of registration of the AIF or date of filing of the PP Memorandum of a scheme with the Board, whichever is later.
- Existing schemes of AIFs and LVFs, which have not declared their First Close, shall declare their First Close within 12 months from the date of this circular, failing which, a fresh application for the launch of the said scheme shall be filed.

The calculation of tenure of a close-ended scheme shall be done by an AIF in the manner specified here under:

- The tenure shall be calculated from the date of declaration of the First Close.
- The tenure of a scheme may be modified at any time before the declaration of its First Close, prior to which, the investor may even withdraw or reduce the commitment provided to such scheme of an AIF.
- Existing schemes of AIFs that have already declared their First Close, may continue to calculate the tenure from the date of the Final Close while those existing schemes which are yet to declare Final Close, shall declare it as per the timeline provided in the PP Memorandum of the scheme.

Fees:

- In case of change in control of manager/sponsor and in case of change in manager/sponsor, a fee, equivalent to single registration fee shall be levied and the same be paid within 15 days from such change. In no scenario, such fee shall be passed on to the investors in any manner.
- The aforesaid fee shall not be levied in the following cases of change in sponsor or change in control of sponsor:
  - the manager is acquiring control in or replacing the sponsor and
  - exit of sponsor(s) in case of AIF having multiple sponsors.

Circular dated 17 November 2022: Scheme of Arrangement (Scheme) by entities having listed their NCDs/NCRPS

SEBI, vide its previous notification dated 14 November 2022 amended the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 to insert new provisions making it mandatory for an entity having listed its NCDs or NCRPS, which intends to undertake a Scheme or is involved in a Scheme, to file such scheme with Stock Exchange(s) for obtaining the No-Objection Letter, before filing such scheme with any court or Tribunal, which shall then be forwarded to SEBI for its approval.

SEBI, vide this circular, provides the operational aspects/requirements to be complied with by such listed entities in this respect, a brief of which is provided hereunder:

- Choose a designated stock exchange
- Submission of varied/specified documents like draft schemes, valuation reports, fairness opinion reports, financials, etc.
- Additional conditions to be fulfilled while the Scheme is between the listed and unlisted entities
- Submitting a report of complaints/comments received by the listed entities on the draft Scheme to the stock exchange
- Notice or proposal sent to the holders of NCDs/ NCRPS for seeking approval of a scheme
- Disclosure to be made on the company website
- Approval of holders of NCDs/ NCRPS to Scheme through e- Voting etc.

The circular also provides for the requirement to be fulfilled by listed entities/resultant entities, post sanction of the Scheme.

Circular dated 23 November 2022: Schemes of AIFs which have adopted priority in distribution among investors (Priority Distribution Model)

As per the extant regulations, the sharing of loss by the sponsor/manager of an AIF, with respect to their investment in AIF, shall at least be proportionate to their holding vis-à-vis the holding of other unit holders in AIF.

However, certain AIFs have adopted a priority distribution model wherein certain class/classes of investors are given priority in distribution as compared to other class/classes of investors (other than sponsor/manager) who then must share loss more than what is proportionate to their holding in the AIF. Accordingly, SEBI has prohibited such schemes of AIFs from accepting any fresh commitment or investing in a new investee company, till any further view is taken by SEBI in this regard.

MINISTRY OF CORPORATE AFFAIRS (MCA)

Notification dated 21 November 2022: The Companies (Registered Valuers and Valuation) Amendment Rules, 2022 (the Amended Rules)

The Amended Rules, inter alia, provides for the following:

- A partnership firm shall not be registered as a registered valuer unless all the partners or directors are eligible

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under rule 3(1) to be registered as registered valuers.

- A partnership firm to be eligible as a registered valuer must be a member of a registered valuer's organisation but cannot be a member of more than one such registered valuer's organisation at any time.
- A registered valuer shall intimate the Insolvency and Bankruptcy Board of India for any change that may affect registration like, change in personal details, the composition of partners/directors or clause of partnership agreement/Memorandum of Association, governing board, etc, after payment of specified fees.
- A member who is a whole-time director in a company registered as a valuer shall not be considered for taking up employment. In case if any member takes up employment, there shall be a temporary surrender of membership of the registered valuers' organisation.
- The schedule/table of fees to be paid to MCA for a change in any detail of a registered valuer is now added.

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

Report on Audit Quality Review

The ICAI has published Report on Audit Quality Review on 02 November 2022. At the level of the Quality Review Board (QRB), during the financial year 2021-2022, QRB completed 24 reviews of the audit quality of 23 entities in India. Out of these 24 completed reviews, QRB issued advisories to concerned Audit firms for further improvement in 22 cases and the other 2 cases were closed. This report highlights the key findings observed in the audit quality reviews conducted during the financial year 2021-2022 indicating the approach for review, key trends, expectations and other focus areas.

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (IBBI)

Circular dated 02 November 2022: Annual Compliance Certificate for Insolvency Professional Agencies

IBBI mandates Insolvency Professional Agencies (IPA) to appoint a compliance officer who shall be responsible for complying with the provisions of the Insolvency and Bankruptcy Code, regulations, circulars, guidelines and directions issued thereunder and mandatorily submit an annual compliance certificate, after verifying the above.

IBBI, vide this circular, has revised the format of the Annual Compliance Certificate for IPAs and every registered IPA shall submit the same to IBBI within 45 days from the end of the financial year.

Circular dated 24 November 2022: Payment of fees to the IBBI

IBBI has revised its fee structure along with relevant forms, applicable to Insolvency professionals (IPs) and Insolvency Professional Entities (IPEs) details of which are as under:

Insolvency Professionals - Individuals

Particulars	Revised Fees
One-time application fees	INR 20,000/-
5 Yearly Fees	INR 20,000/-
Annual Fees	1% of professional fees earned

Insolvency Professionals Entities

Particulars	Revised Fees
One-time application fees for recognition as an IP	INR 200,000/-
One-time application fees for registration of IPE as an IP	INR 200,000/-
5 Yearly Fees	INR 200,000/-
Annual Fees	1% of turnover
Change in composition of Board of IPE	Rs.2,000/- per individual (cessation/joining)

Regulatory Fees

Particulars	Revised Fees
Related to resolution plans	0.25% of the realisable value to creditors
Related to hiring any professional or other services	1.00% of the cost of hiring any professional or other services by IRP or RP.

TAX UPDATES
Direct Tax

CIRCULARS/ NOTIFICATIONS/PRESS RELEASE

The Central Board of Direct Tax (CBDT) releases a draft common income tax return form for public consultation

At present, different Tax Return forms (ITR) are prescribed for a different types of taxpayers. Depending upon the prescribed criteria, the taxpayer is required to use ITR-1 to ITR-7. With a view to bringing the return filing system in tandem with international best practices, the Central Board of Direct Taxes (CBDT) has proposed to merge all the existing returns of income except ITR-7 and has issued a draft common ITR for public consultation. It provides that the current ITR-1 and ITR-4 will continue to apply and that an option to file the tax return either in the existing form (ITR-1 or ITR-4) or in the proposed common ITR shall be given to the taxpayer.

The last date for providing inputs to CBDT is 15 December 2022.

[Draft Circular F. NO. 370133/16/2022-TPL, dated 01 November 2022 and Press Release dated 01 November 2022]

JUDICIAL UPDATES

SC rules that supplementary commission attracts tax withholding under Section 194H of the IT Act

The taxpayer, an airline company, is required to comply with the base fare set by the International Air Transport Association (IATA). IATA provided discretion to airlines to sell their tickets for a net fare lower than the Base Fare, but not higher. In other words, IATA set the ceiling price for how much airlines may charge their customers. The taxpayer was also required to provide a fare list to the Director General of Civil Aviation (DGCA) for approval. The prices that were rubber-stamped by the DGCA may be equivalent to or lower than the Base Fare set by the IATA. Alongside setting the standard pecuniary amount for tickets, the IATA would provide blank tickets to the travel agents acting on behalf of the airlines to market and sell the travel documents. The arrangement between the airlines and the travel agents would be governed by Passenger Sales Agency Agreements (PSA). The draft templates for these contracts are drawn up by the IATA and entered into by various travel agents operating in the sector, with the IATA signs on behalf of the air carriers. The PSAs set the conditions under which the travel agents carry out the aforementioned sale of flight tickets, along with other ancillary services, and the remuneration they are entitled to for these activities. Once these tickets were sold, a designated commission would be paid to the travel agent for its services as a standard commission. Apart from this, the amount charged by travel agents in excess of net-fare was retained by the agents as its supplementary commission.

While the taxpayer withheld tax (TDS) on standard commission, it did not withhold tax on supplementary commission on the basis that it was in nature of the discount and would not fall within the ambit of section 194H of the IT Act. However, the tax officer opined that tax withholding was required and accordingly treated the taxpayer as in default under section 201 of the IT Act and also initiated penalty proceedings under section 271C of the IT Act. On appeal, the First Appellate Authority upheld the order of the Assessing Officer. On further appeal, the Delhi Tax Tribunal held that the provisions of section 194H of the IT Act were not attractive as the taxpayer only received the net fare and did not have any means of knowing the price at which the travel agents had ultimately sold the ticket to the customer. On revenue's appeal, the Delhi High Court held that supplementary commission was a payment that travel agents received from passengers by virtue of the sale of air tickets of which taxpayers were proprietors at a point till the transaction was made, would clearly establish that it was a ‘commission’ within the meaning of section 194H of the IT Act and taxpayer airlines were obliged to withheld tax on supplementary commission.

SC held that section 194H of the IT Act is applicable on supplementary commission. While coming to this conclusion, it made the following observations:

- PSA sets out that any payments collected by an agent pursuant to the sale of air transportation and ancillary services are held in a fiduciary capacity for the carrier until proper accounting is made.
- The contract definitively states that “all monies” received by the agent are held as the property of the air carrier until they have been recorded on the BSP and properly gauged.
- The BSP demarcates “Supplementary Commission” under a separate heading. Hence, once the IATA makes the payment of the accumulated amounts shown on the BSP, it would be feasible for the taxpayer to withhold tax on this additional income earned by the agent.
- **Section 194H is to be read with Section 182 of the Contract Act. If a relationship between two parties as culled out from their intentions as manifested in the terms of the contract between them indicates the**

TAX UPDATES
Direct Tax

existence of a principal-agent relationship as defined under Section 182 of the Contract Act, then the definition of "Commission" under Section 194H of the IT Act stands attracted and the requirement to deduct TDS arises.

Further, the taxpayer had raised a contention that the matter has been rendered revenue neutral since the agents have paid taxes on the Supplementary Commission. In this regard, the SC observed that while tax liability cannot be fastened on the taxpayer if the tax is paid by the agents, the taxpayer is liable to pay interest. Hence, it remanded the matter back to the tax officer to compute interest on the delayed payment of TDS. Also, on the applicability of penal provision, quashing penalty proceedings, it held that the taxpayer had a reasonable cause for not deducting TDS.

[Singapore Airlines Ltd. v. CIT, Civil Appeal No. 6964 To 6968 OF 2015 (SC)]

Polyurethane foam not eligible for deduction under Section 80-IB of the IT Act

The taxpayer is engaged in the manufacture of polyurethane foam [PT foam] which is ultimately used as an automobile seat. It claimed deduction under section 80-IB of the IT Act. Section 80IB of the IT Act grants deduction to certain industrial undertakings engaged in the business of manufacture of an article or thing. However, such an article or thing should not be specified in the Eleventh Schedule of the IT Act. It was contended by the taxpayer that different sizes of PT foam are used as automobile seats and therefore the end product can be said to be the automobile seat which is different than the PT foam and therefore the same does not fall under entry 25 to the Eleventh Schedule of the IT Act. However, the tax officer denied the deduction under section 80-IB of the IT Act by observing that the nature of the business of the taxpayer is "manufacturer of polyurethane foam seats" which falls under entry 25 to the Eleventh Schedule of the IT Act. While the First Appellate Authority upheld the action of the Tax Officer, the Tax Tribunal set aside the order of the Tax Officer. However, High Court upheld the order of the Tax Officer. Hence, the taxpayer filed an appeal before the Supreme Court (SC).

While upholding the order of the Tax Officer (i.e. denial of deduction under section 80-IB of the IT Act), SC made the following observations:

- The taxpayer is manufacturing PT foam and supplying it in different sizes/designs to the assembly operator, which ultimately is being used for car seats.
- The taxpayer is not undertaking any further process for the end product, namely, car seats.
- The PT foam which is supplied in different designs/sizes is being used as an ingredient by others, namely, assembly operators for the car seats. Merely because the taxpayer is using the chemicals and ultimately what is manufactured is PT foam and the same is used by assembly operators after the process of molding as car seats, it cannot be said that the end product manufactured by the taxpayer is car seats/automobile seats.
- There must be a further process to be undertaken by the very taxpayer in manufacturing of the car seats. No further process seems to have been undertaken by the taxpayer except supplying/selling the polyurethane foam in different sizes/designs/shapes which may be ultimately used for end products by others as car seats/automobile seats.
- When the articles/goods which are manufactured by the taxpayer, namely, PT foam is an article classifiable in the Eleventh Schedule (entry 25), considering Section 80IB(2)(iii), the taxpayer shall not be entitled to the benefit under Section 80-IB of the IT Act.

  [Polyflex (India) (P.) Ltd. v. CIT, Civil Appeal NO. 8260 OF 2022 (SC)]

SC rules revaluation of capital assets of a firm by credit to partner's capital accounts post admission of partners taxable as a capital gain.

Taxpayer, a Partnership Firm, is engaged in the business of dyeing and printing, processing, manufacturing and trading in clothing. It originally consisted of four partners. Under the Family Settlement, the share of one of the existing partners having a 25% profit share in the firm was reduced to 12% and, for his balance 13% share, three new partners were admitted. Thereafter, three original partners retired from the Firm. Post that, the Firm was again reconstituted, and new partners were admitted to the Firm. The Taxpayer revalued land and building (held as capital assets) and credited the gain on revaluation to the capital accounts of all the partners in their Profit Sharing Ratio. Two of the existing partners withdrew part of their capital balance. The Tax Officer treated revaluing of the assets, and subsequently crediting it to the respective partners' capital accounts constitutes a transfer and thereby invoked section 45(4) of the IT Act[1]. As land and building were involved, the gain was treated as short-term capital gains. While First Appellate Authority upheld the tax officer's order, the Tax Tribunal and High Court granted relief to the taxpayer. Hence, the tax authority filed an appeal before the Supreme Court.

While upholding the action of the Tax Officer, Supreme Court made the following observations:

- The assets of the taxpayer were revalued to increase the value and the revalued amount was credited to the accounts of the partners in their profit-sharing ratio.

[1] Section 45(4) of the IT Act as it stood prior to the amendment made by Finance Act, 2021. Erstwhile Section 45(4) of the IT Act as introduced by Finance Act 1987 is reproduced hereunder: "(4) The profits or gains arising from the transfer of a capital asset by way of distribution of capital assets on the dissolution of a firm or other association of persons or body of individuals (not being a company or a cooperative society) or otherwise, shall be chargeable to tax as the income of the firm, association or body, of the previous year in which the said transfer takes place and for the purposes of section 48, the fair market value of the asset on the date of such transfer shall be deemed to be the full value of the consideration received or accruing as a result of the transfer."

TAX UPDATES
Direct Tax

- The credit of the assets' revaluation amount to the capital accounts of the partners can be said to be in effect distribution of the assets to the partners
- During the years, some new partners came to be inducted by the introduction of small amounts of capital and the said newly inducted partners had huge credits to their capital accounts immediately after joining the partnership, which amount was available to the partners for withdrawal
- Infact some of the partners withdrew the amount credited in their capital accounts. Therefore, the assets so revalued and the credit into the capital accounts of the respective partners can be said to be "transfer" and which fall in the category of "OTHERWISE" and therefore, the provision of Section 45(4) inserted by Finance Act, 1987 w.e.f. 01 April 1988 shall be applicable.

  [CIT v. Mansukh Dyeing and Printing Mills, Civil Appeal Nos. 8258 TO 8259 OF 2022 (SC)]

SC rules on LTC not be availed for Foreign Trips

Taxpayer, a public sector bank, granted Leave Travel Concession (LTC) to its employees and treated it as an exemption under section 10(5) of the IT Act while computing tax withholding amount. The Tax Officer observed that the travel undertaken by the employees involved foreign leg and hence the provision of section 10(5) of the IT Act was violated. The taxpayer contended that there is no specific bar under section 10(5) of the IT Act for foreign travel and therefore a foreign journey can be availed as long as the starting and destination points remain within India. Further, it also contended that it has considered exemption only with respect to the shortest route of travel between two designated places within India (i.e. foreign leg was not considered). However, the tax officer denied the exemption and thereby raised the demand for not withholding tax on the LTC amount. First Appellate Authority, Tax Tribunal and High Court affirmed the decision of the Tax Officer. Hence, the taxpayer filed an appeal before the Supreme Court.

Supreme Court confirming the Tax Officer's order, made the following observations:

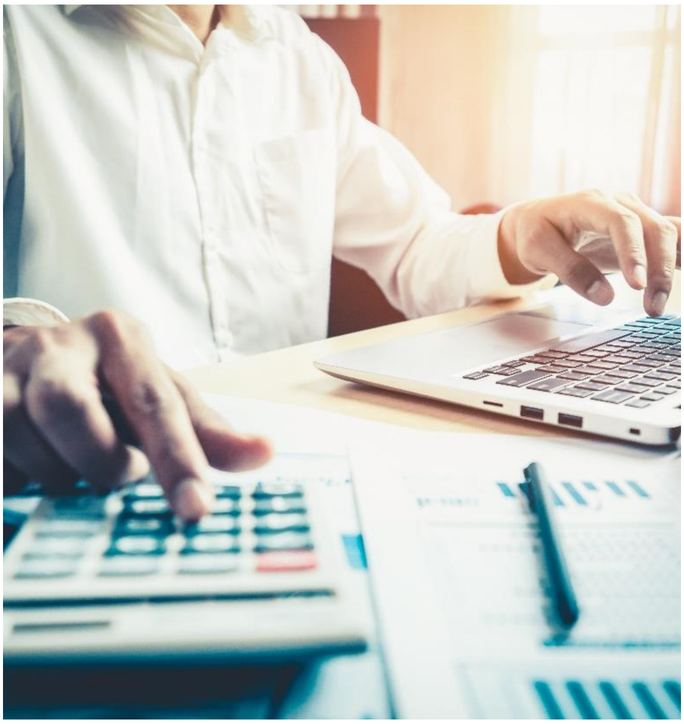
- The contention of the taxpayer that there is no specific bar under section 10(5) for foreign travel and therefore a foreign journey can be availed as long as the starting and destination points remain within India is without merits. LTC is for travel within India, from one place in India to another place in India. There should be no ambiguity on this.
- The moment employees undertake travel with a foreign leg, it is not a travel within India and hence not covered under the provisions of section 10(5) of the IT Act.

  {State Bank of India v. Assistant Commissioner of Income-tax, Civil Appeal No 8181 Of 2022, Dated 4 November 2022}

SC interprets the term 'solely' referred in the conditions for claiming tax exemption by an educational institution

Under Section 10(23C) of the IT Act, institutions engaged in providing education (including universities) can claim exemption provided it fulfills specified conditions. A key condition that needs to be satisfied is that it is existing solely for the purposes of education and not for the purpose of profit. As the term 'solely' is not defined in the IT Act, support needs to be taken from judicial precedence. Recently, the Supreme Court had an occasion to interpret the term 'solely' appearing in Section 10(23C)(vi) of the IT Act whereby it has held that the term solely would mean that the activities of the Charitable Trust should necessarily have all its objects aimed at imparting or facilitating education.

To read BDO analysis of the CBDT notification, please go to: Direct Tax Alert - SC interprets the term 'solely' referred in the conditions for claiming tax exem – BDO



TAX UPDATES
Transfer Pricing

Business Loss can be set off against transfer pricing adjustment made by TPO and Section 40(a)(i) disallowance:

The taxpayer is engaged in the business of call centers and providing IT-enabled services to AE. The taxpayer has four units namely, Mumbai, Hyderabad, Chennai and Gurgaon which are eligible for deduction u/s 10A of the Income Tax Act. For AY 2007-2008, the taxpayer claimed deduction u/s 10A for profit earned for Mumbai and Hyderabad units, while losses incurred for the other two units were carried forward for set off. The AO passed the order after making disallowance under Section 40(a)(i) and TP adjustment. Subsequently, AO issued a rectification order u/s. 154 holding that the set off of business loss resulted into business loss being set off against the income from other sources and therefore, there is a mistake apparent from the record. The taxpayer's contention was that business loss can be set off against transfer pricing adjustment and Section 40(a)(i) disallowance for which the taxpayer preferred an appeal before the learned CIT(A).

Following the decision of the Honorable Bombay High Court in the case of Hindustan Unilever Limited 191 taxmann 119, CIT Versus Patni Computers Systems Limited and CIT Versus Galaxy Surfactants Ltd, CIT(A) held that the loss of eligible units is held to be a business loss. Such losses are allowed to be set off against the other business income of the assessee and if the same is not sufficient, it could also be set off against other income. Moreover, there is no prohibition in the Act for adjustment of transfer pricing adjustment resulting into income, not available for such set-off. Aggrieved, the department went into an appeal before the Tribunal.

Tax Tribunal decision:

The Honorable Mumbai Tribunal upheld the decision of CIT(A) on the ground that AO failed to show any reason as to why the set-off was not as per provisions of section 70 and how the order of the ld. CIT(A) is erroneous. Thus, the Tax Tribunal dismissed the department's appeal.

DCIT. Vs. M/s. Sitel India Pvt. Ltd [TS-833-ITAT-2022(Mum)-TP]

Interest on Compulsorily Convertible Debentures (CCD) paid to AE cannot be disallowed treating it as equity, provisions of section 94B applicable:

The taxpayer is a private limited company engaged in the business of real estate development. During the year under consideration, the taxpayer issued unsecured CCDs to its non-resident AE, which had advanced more than 51% of the book value of the total assets of the taxpayer. The CCDs carried an interest rate of 5% per annum. As per the terms of CCD, after the expiry of five years from the date of allotment, AE shall be entitled to convert the CCDs into equity shares. The taxpayer benchmarked the transaction of payment of interest on CCD using external comparable data and accordingly concluded the transaction to be at arm's length price. The taxpayer, in its return of income, did not comply with the provisions of section 94B to suo moto disallow the excess interest on CCD. The case was referred to the TPO. During the TP assessment proceedings, TPO recharacterised the CCDs as Equity and disallowed the interest payable on it. Aggrieved by the draft assessment order, the taxpayer filed objections before DRP. DRP held that since the Reserve Bank of India has treated CCDs as equity and since conversion is compulsory, it shall be treated as equity rather than debt. Aggrieved, the taxpayer preferred an appeal before the Tax Tribunal.

Tax Tribunal decision:

Bangalore Tax Tribunal held that interest on CCD cannot be disallowed treating it as equity. Bangalore Tax Tribunal observed the following:

- It is well settled by the judicial proposition that CCDs constitute debt and interest payable thereon is a deductible expenditure till the time the same is converted into equity.
- Placing reliance on the decision of Bangalore Tribunal in the case of CAE Flight Training (India) Pvt. Ltd 2019 (8) TMI 554 along with other judicial precedents, the Tribunal held that the definition of convertible debentures given by RBI is in the context of FDI policy to exercise control on future re-payment obligations in convertible foreign currency and since CCDs do not have any repayment obligation, the same was considered by RBI as equity for FDI policy. **Such a definition of the term convertible debentures cannot be applied in another context before the date of conversion. Hence the disallowance of Interest expenditure on CCD cannot be sustained on the basis that CCDs are in the nature of equity.**
- New section 94B of the Income Tax Act is applicable with effect from 01 April 2018 and hence is applicable for the assessment year in consideration. Section 94B is different from transfer pricing provisions contained in sections 92 to 92F of the Income Tax Act. The transfer pricing provisions deal with determining the arm's length rate of interest payable on a debt-claim from an AE, while section 94B places a blanket threshold on the deductibility of interest paid, based on the profitability of the Taxpayer. Further, the definition of AE, referred to in Section 94B is as per Sections 92A(1) and (2). As such, the disallowance is liable to be made under section 94B.

  M/s. Summit Developments Private Limited Vs. DCIT. [TS-789-ITAT-2022(Bang)-TP]

TAX UPDATES
Transfer Pricing

ESOP expenses deducted from employees' payroll and remitted directly to AE cannot form part of operating cost in the absence of impact on the Profit and Loss account of the Taxpayer:

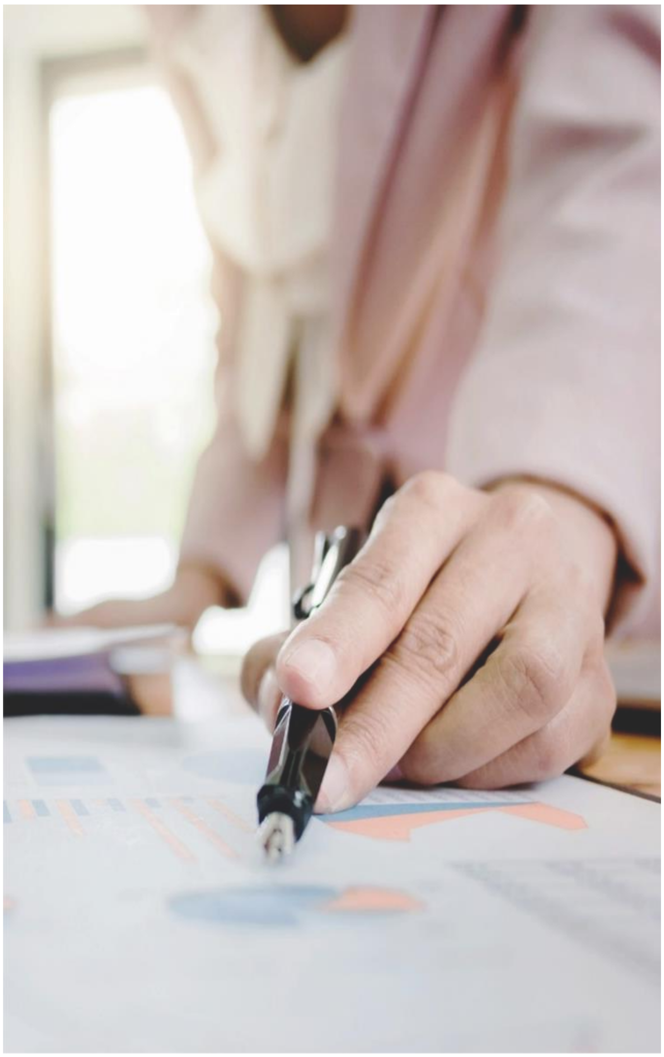
During the year under consideration, employees of the taxpayer under ESOP had the option to purchase the stock of AE at 85% of the market price, which was to be deducted from the payroll of the employees. Further, the discount of 15% offered was treated as perquisite on which TDS u/s 192 was deducted. The amount deducted by the taxpayer from the employee's salary was remitted to AE on a cost-to-cost basis. The TPO considered the amount deducted from the payroll of the employees as the operating cost of the taxpayer. The findings of the TPO were upheld by DRP. Aggrieved, the taxpayer filed an appeal before the Tax Tribunal. The taxpayer contended that this expenditure cannot be held to be an operating cost in the hands of the Taxpayer and the 15% discount given to the employees cannot be treated as a cost in the hands of the assessee being borne on behalf of the AE.

Tax Tribunal decision:

Tax Tribunal held that the ESOP expenses deducted from employees' payroll cannot be treated as operating costs in the hands of the taxpayer. While deciding on the issue, the Tax Tribunal went through the copy of the Stock Incentive Plan, financials, and Employee Information Supplement India (which is specific to the employees of the taxpayer) and observed the following:

- The employees to whom the option is extended are required to make the payment towards the subscription of such shares of the AE directly.
- No expenses are debited to the P&L of the taxpayer for ESOP.

Radisys India Limited Vs. DCIT [TS-823-ITAT-2022(Bang)-TP]



TAX UPDATES
Indirect Tax

GOODS & SERVICE TAX

JUDICIAL UPDATES

ORDERS BY AUTHORITY FOR ADVANCE RULING (AAR)

The subsidised deduction made from the employees who are availing food in the factory would be considered as 'supply' of canteen service and liable to GST

Facts of the case

- M/s. Federal Mogul Goetze India Ltd. (Taxpayer) is engaged in the manufacture, supply and distribution of the auto components used in automobiles and has about 3,200 employees working on a permanent as well as the contractual basis
- The Taxpayer has entered into a contract with a service provider for supply of manpower to operate and manage the canteen within the factory premises and a part of the cost of the meals provided is deducted by the Taxpayer from the salary of the employees on a monthly basis
- The canteen is operated by the Taxpayer and all the equipment and items essential for running the canteen such as grocery, utensils, cooking equipment, etc. are arranged by the Taxpayer
- The Taxpayer has entered into a separate contract with a service provider for providing/supplying manpower required to manage the canteen operations; the service provider raises monthly invoices towards the supply of manpower for canteen operations and charges applicable GST
- The Taxpayer does not avail ITC of the GST paid to the service provider or on any other canteen expenses incurred.

Question before the AAR

- Whether the subsidised deduction made by the Taxpayer from the employees who are availing food in the factory would be considered as a 'supply' by the Taxpayer under the provisions of Section 7 of the CGST Act, 2017:
- In case the answer to the above is 'yes', whether GST is applicable on the nominal amount being recovered by the Taxpayer
- Whether Input Tax Credit (ITC) of the GST charged by the service provider would be eligible for availment to the Taxpayer

Contention of the Taxpayer

- The Taxpayer contended that the nominal amount deducted from the salary of the employees towards the canteen facility cannot be considered as supply under Section 7 of the CGST Act 2017, and therefore, not leviable to GST based on the following grounds:
  - The Taxpayer provides a canteen facility to all their employees including contractual employees to abide by the legal mandate provided under the Factories Act, 1948. There is no legal intention to enter into any contractual relationship by the Taxpayer and the employees. [Reliance was placed on European Court of Justice (ECJ) decision in R.J. Tolsma Vs Inspecteur 'der Omzetbelasting Leeuwarden]
  - There is no reciprocity of any activity or transaction inter se between the Taxpayer and the employee. In the absence of an identifiable activity/transaction, the same would not be constituted as 'consideration' for supply. (See Bai Mamubai Trust, Vithaldas Laxmidas Bhatia, Smt. Indu Vithaldas Bhatia Vs Suchitra [2019-VIL-454-BOM])
  - The provision of canteen facilities cannot be construed to be covered within the definition of 'business' under Section 2(17) of the CGST Act, 2017
  - Provision of a canteen facility only to the employees is in the course of the employment relationship as per para 3 of the CBIC press release dated 10 July 2017
  - Reliance is placed on the advance rulings on similar issues in case of M/s Tata Motors Limited [2020-VIL-257-AAR], M/s The Tata Power Company Limited [2021-VIL-411-AAR], M/s Posco India Pune Processing Center Private Limited [2019-VIL-25-AAR], M/s Jotun India Pvt. Ltd., [2019 (10) TMI 482-2019-VIL-296-AAR].
- With regard to 'eligibility to claim ITC', the Taxpayer contended that the canteen facility is set up by them only on account of a statutory mandate laid down under the Factories Act, 1948. Consequently, ITC of GST paid towards availing manpower supply services, which are used for the purpose of providing such canteen facility should be allowed as credit as the same is not restricted under Section 17(5) of the CGST Act, 2017.

Observations & ruling by the AAR

The activity of providing subsidised canteen facility to employees qualifies as supply on the below grounds in response to the contentions of the Taxpayer:

- The Taxpayer has incorrectly quoted the judgement R.J. Tolsma (supra) as the facts and the underlying jurisprudence are different to the case of the Taxpayer wherein obligations and considerations are clearly defined for the provision of canteen facility to employees;

TAX UPDATES
Indirect Tax

- The fact that consideration is being charged by the Taxpayer and paid by the employee is sufficient to establish a contractual relationship with reciprocal obligations leading to the supply of service;
- The Taxpayer is a manufacturer, and thus, their activity is covered under Section 2(17)(a) of the CGST Act, 2017. Further Section 2(17)(b) stipulates that any activity/transaction in connection with Section 2(17)(a), is included in the business
- The canteen facility undoubtedly helps in the progress of the business, as the same provides facility to the employees who are involved in the production. Thus, the same is useful for the furtherance of the business of the Taxpayer
- In the instant case, the supplies by an employer to an employee are not free of charge. Hence, para 3 of the CBIC press release dated 10 July 2017 will not support the case of the Taxpayer
- It was noted that in the instant case, the Taxpayer is providing a canteen facility, and hence, the advance rulings relied upon by the Taxpayer would not apply to the present case
- The Taxpayer and their employees are related persons and the supply is in the nature of canteen services (SAC 996333), wherein open market value and the value of like kind and quality are not available from the facts furnished by the Taxpayer, hence Rule 28(c) of CGST Rules, 2017 shall be adopted for valuation. In accordance with 28(c) the value of the impugned supply has to be determined by the application of Rule 30 or Rule 31 of the CGST Rules 2017
- On the manpower service utilised for running the canteen facility, the services of the Taxpayer are covered under services provided in the canteen and other establishments and merit classification under SAC 996333. The said services attract GST at 5%, without ITC in terms of entry no:7 of the notification no:11/2017-CT(R) dated 28 June 2017, as amended
- Based on the above observations the AAR held as follows:
  - The subsidised deduction made by the Taxpayer, from the employees who are availing food in the factory, is a 'supply' of canteen service by the Taxpayer under the provisions of Section 7 of the CGST Act, 2017. GST is liable to be paid on the value determined under Rule 30 or 31 of the CGST Rules 2017
  - The Taxpayer is not eligible to avail ITC of the GST paid on the manpower supply services used for providing the canteen facility.

  [AAR-Karnataka, M/s. Federal Mogul Goetze India Ltd., Ruling no:KAR ADRG 42/2022 dated 29 November 2022]

EXCISE/SERVICE TAX/CUSTOMS

No reversal of CENVAT required where the credit availed and utilised for payment of Service Tax on non-taxable supplies

Facts of the case

- M/s. Gautam Freight Private Ltd. (Taxpayer) is engaged in providing cargo handling service during the period June 2005 to September 2005. The Taxpayer has paid Service Tax on such services and also availed of CENVAT credit of the Service Tax paid on relevant input services
- The Tax authority issued a show cause notice demanding reversal of CENVAT credit on the ground that the cargo handling service of export cargo provided by the Taxpayer is a non-taxable supply, and therefore, CENVAT availed by the Taxpayer is liable to be reversed;
- The Tax authority passed the final order confirming the allegations in the SCN and thereby demanding the reversal of CENVAT credit utilised along with applicable interest and penalty.

Contention by Tax authorities

- The contention of the Tax authorities is that the definition of cargo handling service under Section 65(23) of the Finance Act, 1994 specifically excludes cargo handling for export cargo;
- Since the Taxpayer's output activity is not a taxable service, the Taxpayer is not entitled for CENVAT credit of input service used for such non-taxable service.

Contention by the Taxpayer

- The Taxpayer submitted that even though export cargo handling was not a taxable service, the Taxpayer has erroneously paid the Service Tax which is higher than the amount of CENVAT credit availed on input service which would be attributable to the export cargo handling service. Therefore, the CENVAT credit cannot be said to have been wrongly taken by the Taxpayer
- Taxpayers also placed reliance on the CESTAT decision in Gateway Distriparks Ltd Vs. Commissioner of C. EX., Raigad [2019 (28) GSTL135(Tri.-Mumbai)].

Observations & Ruling by the CESTAT

- CESTAT observed that though export cargo handling service was not a taxable service, but the Taxpayer have admittedly paid the Service Tax, and the same was accepted by the Tax authorities since no objection was raised regarding the payment of the Service Tax
- By relying on Gateway Distriparks Ltd. (supra), CESTAT held that when the Taxpayer has paid the Service Tax, the corresponding CENVAT credit is admissible and made reliance on Gateway Distriparks Ltd Vs. CCE, Raigad-2019 (28) GSTL (135) (Tri.,- Mumbai)

TAX UPDATES
Indirect Tax

- In view of the above, the CESTAT allowed the appeal filed by the Taxpayer and remanded the matter to the Tax authority for passing a fresh order based on the aforesaid analysis.

  [CESTAT-Ahmedabad, M/s. Gautam Freight Private Limited Vs C.C.E. & S.T.-Rajkot, 2022-VIL-902-CESTAT-AHM-ST]

All parties to a co-development agreement assigned with respective jobs are considered an active party to the joint venture, Service Tax shall not be payable as a Business Support Service provider

Facts of the case

- Co-development agreement was entered into between M/s. Safal Construction Pvt Limited ('SCPL' or 'Taxpayer'), Safal Realty Pvt. Limited (SRPL) and Pegasus Commercial Co-op Society for joint development of Pegasus Commercial Complex
- The Taxpayer has not paid Service Tax in relation to the joint development under the agreement;
- The Tax authority claimed that the Taxpayer is engaged in obtaining required permissions for the project, and hence, they are liable to pay Service Tax under the category of 'Support Service for Business and Commerce' as defined under the Finance Act, 1994
- Tax authority issued a Show Cause Notice (SCN) on the above issue which was subsequently confirmed.

Issue under consideration

- Whether the activity of the Taxpayer falls under the category of Business Support Service

Submissions by the Taxpayer

- The taxpayer submitted that as per the co-development agreement, the activities were assigned as part of the overall work of development of property in the capacity of co-developer
- There is no service exists among equally placed co-developers in a joint venture therefore, no Service Tax is payable
- In this regard Taxpayer referred to CBEC circular no:151/12/2012- ST dated 10 February 2012, 148/17/2011-ST dated 13 December 2011 and 334/4/2006-TRU dated 28 February 2006 and submitted that as per circulars also the activities of the Taxpayer do not fall under business support service
- Taxpayer further submitted that the entire demand is raised by invoking an extended period.

Observations & Ruling by the CESTAT

- Upon review of the terms of the contract, the CESTAT observed that Taxpayer is an active party to the joint venture with SRPL and Pegasus, and the consideration is on the basis of profit share in the joint venture
- The taxpayer is not providing any service to any other person/joint venture and the Taxpayer was assigned the work in the capacity of co-developer and not an agent
- The agreement does not indicate that the Taxpayer is a service provider providing services to the joint venture. As per the agreement, all the parties to a co-development agreement have been assigned their respective jobs which must be performed towards the objective of the joint venture arrangement
- The taxpayer has not provided any service to a joint venture and the activity of the Taxpayer does not fall under the category of Business Support Service
- Since suppression of fact or any malafide to evade payment of Service Tax is not established, the demand of Service Tax is also barred by limitation also. Accordingly, the Impugned order is set aside and the appeal is allowed.

  [CESTAT-Ahmedabad, M/s. Safal Construction Pvt Limited, 2022-VIL-907-CESTAT-AHM-ST dated 28 November 2022]

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