ACCOUNTING, REGULATORY & TAX NEWSLETTER

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INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA ("ICAI")

EAC Opinion – Adoption of the 'Net Book Value' method as one of the valuation techniques to measure the fair value of investments in equity instruments that do not have a quoted market price in an active market

Facts of the case

A company is a wholly owned Government of India company established under the Department of Atomic Energy, primarily to meet the control and instrumentation requirements of India's nuclear power programme.

A Corporation Ltd. has the first gas-based power plant that was set up in the State. In the year 1990, when there was an acute shortage of power in the State, the Electricity Board invited private companies to start gas power projects under public and private partnership (PPP) mode.

Through such PPP mode, the Company as a promoter shareholder had invested in A Corporation Ltd. to the tune of INR 91.12lakhs. A Corporation Ltd. is not a listed company in any of the Stock Exchanges. In addition to the investment in A Corporation Ltd., the Company holds shares in two other entities, viz., its joint venture, X Ltd. and Y Consumer Co-operative Society Limited. All these three investments are being disclosed in the 'Investment' schedule in the Company's balance sheet.

Pre-Ind AS Regime: The Company has stated that prior to the adoption of Indian Accounting Standards (Ind ASs), i.e. till the end of 31 March 2015, the Company in line with Accounting Standard (AS) 13, 'Accounting for Investments', had framed the accounting policy on investments as under:

"Long-term Investments are carried at cost. Provision is made for diminution, other than temporary, in the value of such investments."

Accordingly, the Company had been disclosing the value of investments made in X Ltd., A Corporation Ltd. and Y Consumer Co-operative Society Limited at cost. i.e. at INR 73.50lakhs, INR 91.12lakhs and INR 0.02lakhs respectively.

Post-adoption of Ind AS: Post implementation of Ind AS, during the F.Y. 2016-2017 and 2017-2018, the Company had adopted the following accounting policy in respect of accounting for investments as the Company had not consolidated the accounts with that of the joint venture company.

"Investments including Investments in a joint venture are valued at Fair Value under the Net Book Value method."

However, based on the opinion issued by the Expert Advisory Committee of the ICAI, from the financial year (F.Y.) 2018-2019 onwards, the Company is preparing the consolidated accounts with that of a Joint venture company and accordingly revised the accounting policy on investments as under:

"Investments other than investments in the joint venture are valued at Fair Value through Other Comprehensive Income (FVOCI) under Net Book Value Method. Investments in Joint Venture are valued at Cost."

Since then, for each financial year, the Company had been valuing the investment in A Corporation Ltd. at fair value through OCI. For re-measuring, the value of investments in A Corporation Ltd., the Company had been adopting the net book value method based on the latest audited financial statements of A Corporation Ltd. and accordingly routing the re-measurement made through 'Other Comprehensive Income'.

Current Scenario:

The Company has further stated that the Company, being a public sector enterprise, is subject to supplementary audit by the Comptroller and Auditor General of India (C&AG). During the course of supplementary audit for the F.Y. 2020-2021, the C&AG audit team issued an audit query stating that "Valuation of investment in equity shares of A Corporation Ltd. as per net book value method instead of cost had resulted in overstatement of Investments". The contention of the C&AG audit team was based on the following factors:

- The net book value method or equity method is a prescribed method of valuation of investments in associates or joint ventures according to Ind AS 28, 'Investments in Associates and Joint Ventures' or Ind AS 31, 'Interests in Joint Ventures'.
- The investments in equity instruments of an unlisted company which is neither an associate nor joint venture need to be measured according to Ind AS 39, 'Financial Instruments: Measurement and Recognition'.
- As per paragraph 9 of Ind AS 39, investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured shall not be designated as at fair value through profit or loss.
- Also, as per paragraph 46(c) of Ind AS 39, after initial recognition, an entity shall measure financial assets at their fair values except for investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured, which shall be measured at cost. Hence, based on the above factors and since the equity shares of A Corporation Ltd. are not traded in an active market, the C&AG audit team contended that the investment in A Corporation Ltd. needs to be measured at cost and not doing so (adopting net book value method) had resulted in overstatement of investments and thereby the other comprehensive income.

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Company's viewpoints:

- As per paragraph 46 of Ind AS 39, after initial recognition, an entity shall measure financial assets at their fair values.
- Paragraph AG74 of Ind AS 39 deals with valuation techniques in case of no active market-related instruments. If the market for financial instruments is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arms market transactions between knowledgeable, willing parties, if available.
- Since the Company is a joint promoter shareholder, i.e., 25 companies jointly floated A Corporation Ltd. to generate the power and to utilise the same for their captive consumption, the value of the instrument cannot be inferred from an outside market since it is a closely held company.
- Paragraph AG74 of Ind AS 39 suggests the valuation techniques, "to include …" i.e. it is an inclusive definition but not a restrictive or exhaustive definition.
- Since the 'Net Book Value' method is one of the accepted methods for valuation, the Company has chosen this method based on the latest available audited financials of A Corporation Ltd. which gets recorded at various Government agencies like Registrar of Companies (ROC), Income tax Authorities, etc.
- In view of the above, it is felt that the valuation method adopted for investments in A Corporation Ltd. based on the net book value method is in order.

Query

In view of the above, the opinion of the Expert Advisory Committee is sought as to whether the adoption of the 'Net Book Value' method by the Company as one of the valuation techniques to measure the fair value of investments in equity instruments of A Corporation Ltd. that do not have a quoted market price in an active market is in order or shall be measured at cost.

Points considered by the Committee

The Committee notes that the basic issue raised in the query relates to the valuation of investment in equity instruments of A Corporation Ltd. (a closely held company) that do not have a quoted market price in an active market and which is not an investment in the subsidiary, joint venture and associates. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case.

At the outset, the Committee wishes to point out that Ind AS 31, 'Interests in Joint Ventures' and Ind AS 39, 'Financial Instruments: Recognition and Measurement' were not notified under Companies (Indian Accounting Standards) Rules, 2015 and hence, the same are not applicable in the extant case. With regard to the valuation of investment in equity instruments of A Corporation Ltd., the Committee notes that A Corporation Ltd. is not a subsidiary, joint venture or associate of the Company. Further, the investments in equity instruments being financial assets as per the requirements of Ind AS 32, 'Financial Instruments: Presentation', the requirements of Ind AS 109, 'Financial Instruments' are applicable for financial reporting of such investments (financial instruments). Accordingly, in the context of the issue raised, the Committee notes the following requirements of Ind AS 109:

"4.1 Classification of financial assets

4.1.1 Unless paragraph 4.1.5 applies, an entity shall classify financial assets as subsequently measured at amortised cost, fair value through other comprehensive income or fair value through profit or loss on the basis of both:

- The entity's business model for managing the financial assets and
- The contractual cash flow characteristics of the financial asset.

4.1.2 A financial asset shall be measured at amortised cost if both of the following conditions are met:

- The financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions.

4.1.2A A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:

- The financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and
- The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply these conditions.

4.1.4 A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost in accordance with paragraph 4.1.2 or at fair value through other comprehensive income in accordance with paragraph 4.1.2A. However, an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income (see paragraphs 5.7.5–5.7.6)."

"Investments in equity instruments

5.7.5 At initial recognition, an entity may make an irrevocable election to present in other comprehensive income subsequent changes in the fair value of an investment in an equity instrument within the scope of this Standard that is neither held for trading nor contingent consideration recognised by an acquirer in a business combination to which Ind AS 103 applies. …"

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"Investments in equity instruments and contracts on those investments

B5.2.3 All investments in equity instruments and contracts on those instruments must be measured at fair value. However, in limited circumstances, the cost may be an appropriate estimate of fair value. That may be the case if insufficient more recent information is available to measure fair value, or if there is a wide range of possible fair value measurements and cost represents the best estimate of fair value within that range.

B5.2.4 Indicators that cost might not be representative of fair value include:

- A significant change in the performance of the investee compared with budgets, plans or milestones.
- Changes in the expectation that the investee's technical product milestones will be achieved.
- A significant change in the market for the investee's equity or its products or potential products.
- A significant change in the global economy or the economic environment in which the investee operates.
- A significant change in the performance of comparable entities, or in the valuations implied by the overall market.
- Internal matters of the investee such as fraud, commercial disputes, litigation, changes in management or strategy.
- Evidence from external transactions in the investee's equity, either by the investee (such as a fresh issue of equity) or by transfers of equity instruments between third parties.

B5.2.5 The list in paragraph B5.2.4 is not exhaustive. An entity shall use all information about the performance and operations of the investee that becomes available after the date of initial recognition. To the extent that any such relevant factors exist, they may indicate that cost might not be representative of fair value. In such cases, the entity must measure fair value."

From the above, the Committee notes that the investments in equity instruments falling within Ind AS 109 are to be measured at fair value; however, as per the requirements of paragraphs 4.1.4 and 5.7.5 of Ind AS 109, an entity may make an irrevocable election at initial recognition for particular investments in equity instruments that would otherwise be measured at fair value through profit or loss to present subsequent changes in fair value in other comprehensive income. Further, paragraph D19B of Ind AS 101, 'First-time Adoption of Indian Accounting Standards' gives the option to designate an investment in an equity instrument as at fair value through other comprehensive income in accordance with paragraph 5.7.5 of Ind AS 109 on the basis of the facts and circumstances that exist at the date of transition to Ind ASs. Accordingly, since such an option has been elected by the Company for the investments in equity instruments of A Corporation Ltd. in the extant case, the subsequent measurement of such investments at fair value through OCI is correct. Further, the Committee notes that as per Ind AS 109, all investments in equity instruments are to be measured at fair value irrespective of whether these are quoted or not quoted in an active market except in limited circumstances, where cost may be an appropriate estimate of fair value, as per paragraphs B5.2.3 to B5.2.5.

With regard to the measurement of investment in A Corporation Ltd. at fair value, the Committee notes that as per the requirements of Ind AS 109, fair value has to be determined as per the requirements of Ind AS 113, 'Fair Value Measurements'. Therefore, the Committee notes the following requirements of Ind AS 113:

"Definition of fair value

9 This Ind AS defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date."

"3 When a price for an identical asset or liability is not observable, an entity measures fair value using another valuation technique that maximises the use of relevant observable inputs and minimises the use of unobservable inputs. Because fair value is a market-based measurement, it is measured using the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. As a result, an entity's intention to hold an asset or to settle or otherwise fulfil a liability is not relevant when measuring fair value."

The transaction

15 A fair value measurement assumes that the asset or liability is exchanged in an orderly transaction between market participants to sell the asset or transfer the liability at the measurement date under current market conditions.

"Valuation techniques

61 An entity shall use valuation techniques that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs.

62 The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the cost approach and the income approach. The main aspects of those approaches are summarised in paragraphs B5- B11. An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value.

63 In some cases a single valuation technique will be appropriate (eg when valuing an asset or a liability using quoted prices in an active market for identical assets or liabilities). In other cases, multiple valuation techniques will be appropriate (eg that might be the case when valuing a cash-generating unit). If multiple valuation techniques are used to measure fair value, the results (ie respective indications of fair value) shall be evaluated considering the reasonableness of the range of values indicated by those results. Fair value measurement is the

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point within that range that is most representative of fair value in the circumstances.

64 If the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique shall be calibrated so that at initial recognition the result of the valuation technique equals the transaction price. … After initial recognition, when measuring fair value using a valuation technique or techniques that use unobservable inputs, an entity shall ensure that those valuation techniques reflect observable market data (eg the price for a similar asset or liability) at the measurement date."

"Fair value hierarchy

72 To increase consistency and comparability in fair value measurements and related disclosures, this Ind AS establishes a fair value hierarchy that categorises into three levels (see paragraphs 76-90), the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs)."

"Level 1 inputs

76 Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the entity can access at the measurement date.

77 A quoted price in an active market provides the most reliable evidence of fair value and shall be used without adjustment to measure fair value whenever available, except as specified in paragraph 79."

"Level 2 inputs

81 Level 2 inputs are inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

82 If the asset or liability has a specified (contractual) term, a Level 2 input must be observable for substantially the full term of the asset or liability. Level 2 inputs include the following:

- Quoted prices for similar assets or liabilities in active markets.
- Quoted prices for identical or similar assets or liabilities in markets that are not active.
- Inputs other than quoted prices that are observable for the asset or liability, for example:
  - Interest rates and yield curves observable at commonly quoted intervals;
  - Implied volatilities; and
  - Credit spreads.
  - Market-corroborated inputs."

"Level 3 inputs

86 Level 3 inputs are unobservable inputs for the asset or liability.

87 Unobservable inputs shall be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which there is little if any, market activity for the asset or liability at the measurement date. However, the fair value measurement objective remains the same, ie an exit price at the measurement date from the perspective of a market participant that holds the asset or owes the liability. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk."

"89 An entity shall develop unobservable inputs using the best information available in the circumstances, which might include the entity's own data. In developing unobservable inputs, an entity may begin with its own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy). An entity need not undertake exhaustive efforts to obtain information about market participant assumptions. However, an entity shall take into account all information about market participant assumptions that is reasonably available. Unobservable inputs developed in the manner described above are considered market participant assumptions and meet the objective of a fair value measurement."

From the above, the Committee notes that as per the requirements of Ind AS 113, when measuring fair value, the objective is to estimate the price at which an orderly transaction to sell an asset or to transfer a liability would take place between market participants at the measurement date under current market conditions.

The Standard states that there are three widely used valuation techniques, viz., the market approach, the cost approach and the income approach. The Standard prescribes to use of valuation techniques consistent with one or more of these approaches to measure fair value, and that are appropriate in the circumstances and for which sufficient data are available to measure fair value, maximising the use of relevant observable inputs and minimising the use of unobservable inputs. In some cases, a single valuation technique will be appropriate, while in other cases, multiple valuation techniques will be appropriate. Further, the Standard states that the availability of relevant inputs and their relative subjectivity might affect the selection of appropriate valuation techniques. However, the fair value hierarchy prioritises the inputs to valuation techniques, not the valuation techniques used to measure fair value.

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Ind AS 113 also establishes a fair value hierarchy that categorises into three levels, the inputs to valuation techniques used to measure fair value. The fair value hierarchy gives the highest priority to quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1 inputs) and the lowest priority to unobservable inputs (Level 3 inputs). Thus, the Standard does not prescribe the use of a specific valuation technique or a hierarchy of valuation techniques; rather it only provides a hierarchy of inputs to valuation techniques.

From the above, the Committee notes that fair valuation involves judgement not only when applying a valuation technique, but also in the selection of a valuation technique. However, whichever approach or technique(s) is used, the objective of fair valuation should be kept in mind, i.e. an exit price at the measurement date from the perspective of a market participant that holds the asset.

In this context, the Committee notes that the investment in the extant case is made in A Corporation Ltd., which is a closely held company and not a listed company and hence level 1 inputs may not be available. Accordingly, as per the above-mentioned requirements of Ind AS 113, the Company should use level 2 inputs (i.e. observable inputs such as quoted prices of similar assets in an active market or in markets that are not active, interest rates and yield curves observable at commonly quoted intervals, implied volatilities, credit spreads market corroborated inputs, etc.) or if these are not available, the Company should use Level 3 inputs that are unobservable inputs. However, the fair value measurement objective, as discussed above, should be kept in mind. Therefore, unobservable inputs shall reflect the assumptions that market participants would use when pricing the asset or liability, including assumptions about risk. Further, the Company can develop unobservable inputs using the best information available in the circumstances, which might include the Company's own data, but it shall adjust those data if reasonably available information indicates that other market participants would use different data or there is something particular to the entity that is not available to other market participants (eg an entity-specific synergy). Further, where such unobservable inputs are used to measure fair value, as per paragraph 64 of the Standard if the transaction price is fair value at initial recognition and a valuation technique that uses unobservable inputs will be used to measure fair value in subsequent periods, the valuation technique should be calibrated so that at initial recognition the result of the valuation technique equals the transaction price.

Thus, in spite of A Corporation Ltd. being an unlisted company and the absence of availability of observable market transactions and other market information, the Company should determine the fair value considering its specific facts and circumstances using valuation technique(s) and using one or more observable and unobservable inputs; and keeping in view the objective of fair value measurement and other requirements of Ind AS 113. However, the Committee notes that in the extant case, the Company has apparently taken its share in the net book value/carrying amount of net assets of A Corporation Ltd. as on the reporting date as a substitute for fair value. The Committee is of the view that while determining fair value, net book value/carrying amount of net assets could be used as the beginning point or as one of the inputs, which may require further adjustments as per valuation technique(s) considering the requirements of Ind AS 113, but the same itself cannot be directly considered as a substitute of fair value. Therefore, since the Company has not apparently followed the above approaches, techniques and methodology prescribed under Ind AS 113 to determine fair value in the extant case, the same is not appropriate.

Opinion

On the basis of the above, the Committee is of the view that since the option under paragraph D19B of Ind AS 101 has been elected by the Company for the investments in equity instruments of A Corporation Ltd. in the extant case, the subsequent measurement of such investments at fair value through OCI is correct, as discussed above.

With regard to the method of valuation, the Committee is of the view that the Company should determine the fair value considering its specific facts and circumstances using valuation technique(s) and using one or more observable and unobservable inputs; and keeping in view the objective of fair value measurement and other requirements of Ind AS 113. However, in the extant case, the Company has apparently taken the share in the net book value/carrying amount of net assets of A Corporation Ltd. as on the reporting date as a substitute of fair value. The Committee is of the view that while determining fair value, net book value/carrying amount of net assets could be used as the beginning point or as one of the inputs, which may require further adjustments as per the valuation technique(s) considering the requirements of Ind AS 113, but the same itself cannot be directly considered as a substitute of fair value. Therefore, since the Company has not apparently followed the above approaches, techniques and methodology prescribed under Ind AS 113 to determine fair value in the extant case, the same is not appropriate.

With regard to using 'cost' as the basis of valuation of equity instruments, the Committee is of the view that as per paragraphs B5.2.3 to B5.2.5 of Ind AS 109, all investments in equity instruments are to be measured at fair value irrespective of whether these are quoted or not quoted in an active market except in limited circumstances, where cost may be an appropriate estimate of fair value.

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SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Extension of timeline for entering the details of the existing outstanding non-convertible securities in the 'Security and Covenant Monitoring' system hosted by Depositories

The SEBI vide circular dated 03 October 2022 extended the timeline for entering the details of the existing outstanding non-convertible securities in the 'Security and Covenant Monitoring' system hosted by Depositories to protect the interest of investors in securities and to promote the development of, and to regulate, the securities market.

Earlier, SEBI vide circular dated 13 August 2021 specified the manner of recording of charges by Issuers and the manner of monitoring and other responsibilities of Debenture Trustees (DTs), Credit Rating Agencies, etc. for 'Security and Covenant Monitoring' using Distributed Ledger Technology (DLT).

Later, SEBI vide Circular dated 29 March 2022, also specified the Operating Guidelines of the said system using DLT, including roles and responsibilities of the various stakeholders involved.

SEBI is in receipt of representations from depositories that issuers have requested for extension in the timeline of entering the legacy data, viz. details of the existing outstanding non-convertible securities.

On consideration, SEBI decided to provide an extension of one month. Accordingly, it is informed that for existing outstanding non-convertible securities, issuers shall ensure that they enter the details into the DLT system on or before 31 October 2022 and DTs shall verify the same by 31 December 2022.

Execution of 'Demat Debit and Pledge Instruction' (DDPI) for transfer of securities towards deliveries/settlement obligations and pledging/re-pledging of securities - Clarification

The SEBI vide circular dated 06 October 2022, widened the scope of DDPI by including the following:

- Mutual Fund transactions being executed on Stock Exchange order entry platforms; and
- Tendering shares in open offers through Stock Exchange platforms.

SEBI vide circular dated 04 April 2022, issued guidelines regarding the execution of DDPI for the transfer of securities towards deliveries/settlement obligations and pledging/re-pledging of securities. Further, in July, SEBI extended the deadline for implementation by 2 months to 01 September 2022. With the implementation of the guidelines, the DDPI replaced the Power of Attorney (PoA) document.

In order to make the process more transparent and simpler, the following conditions shall be made part of a separate document viz. 'Demat Debit and Pledge Instruction' (DDPI).

- Transfer of securities held in the beneficial owner accounts of the client towards Stock Exchange-related deliveries/settlement obligations arising out of trades executed by clients on the Stock Exchange through the same stockbroker.
- Pledging/re-pledging of securities in favour of trading member (TM)/clearing member (CM) for the purpose of meeting margin requirements of the clients in connection with the trades executed by the clients on the Stock Exchange.
- Mutual Fund transactions being executed on stock exchange order entry platforms and which shall be in compliance with SEBI's earlier circular dated 04 October 2021 and 15 March 2022.

Securities transferred on the basis of the DDPI provided by the client shall be credited to the client's TM pool account/CM pool account/demat account of the clearing corporation, as the case may be. The DDPI provided by the client shall be registered in the demat account of the client by TM/CM. Stock Exchanges and Depositories shall ensure that the stock broker/stock broker and depository participant providing the DDPI facility, has enabled its clients to revoke/cancel the DDPI provided by them.

This circular shall be applicable from 18 November 2022.

Governing Council for Social Stock Exchange (SSE)

The SEBI vide circular dated 13 October 2022, issued a framework on Governing Council for Social Stock Exchange. As per Regulation 292D of the SEBI (Issue of Capital and Disclosure Requirements) Regulations, 2018 (ICDR Regulations), every Social Stock Exchange is required to constitute a Social Stock Exchange Governing Council (SGC) to have an oversight on its functioning, with composition and terms of reference as specified by the Board.

The SGC shall provide oversight and guidance to facilitate the smooth functioning of the operations of the Social Stock

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Exchange, with regard to registration, fundraising and disclosures by Social Enterprises.

The SGC shall comprise of individuals with relevant expertise of various categories as specified in the circular like Non-profit organizations, Information Repositories, Social Impact Investors, Stock Exchange, etc. who can contribute to the development of SSE. SGC will have a minimum of 7 members having representation from each of the categories as specified in the circular. SGC shall be supported by administrative staff from the SSE.

The Board of the Stock Exchange shall prescribe the procedure, frequency, quorum, etc. for the meetings of SGC as well as guidelines for handling potential conflicts of interest if any. SGC shall meet as frequently as required with a minimum of four meetings in a financial year.

The Stock Exchange shall constitute a Governing Council for the Social Stock Exchange prior to seeking final approval from SEBI for the introduction of the Social Stock Exchange as a separate segment.

Request for Quote (RFQ) platform for trade execution and settlement of trades in listed Non-convertible Securities, Securitised Debt Instruments, Municipal Debt Securities and Commercial Paper

The SEBI has issued a circular dated 19 October 2022 on the Request for Quote (RFQ) platform for trade execution and settlement of trades in listed Non-convertible Securities, Securitised Debt Instruments, Municipal Debt Securities and Commercial Paper to bring in transparency in "Over the Counter" deals which are negotiated bilaterally and to facilitate wider market participation in the corporate bond market. The provisions of this circular will come into effect from 01 January 2023.

Key Points:

- The framework for a dedicated debt segment was introduced by SEBI circular dated January 2013, permitting the stock exchanges to offer electronic, screen-based trading providing for order matching, request for a quote, negotiated trades, etc.
- In February 2020, after necessary approvals from SEBI, both the National Stock Exchange of India Limited and BSE Limited launched RFQ platforms, as an extension of their existing trade execution and settlement platforms, to bring in transparency in "Over the Counter" deals which were negotiated bilaterally.
- RFQ platform was introduced as a 'participant-based' model wherein all regulated entities, listed bodies corporate, institutional investors and all Indian financial institutions were eligible to register, access and transact. To enhance liquidity on the RFQ platforms of the stock exchanges, SEBI has, inter alia, mandated registered Mutual Funds and Portfolio Management Services, to undertake a specified percentage of their total secondary market trades in Corporate Bonds through the RFQ platform of stock exchanges. IRDAI has also prescribed similar stipulations for Insurers.
- RFQ is an electronic platform to enable sophisticated, multi-lateral negotiations to take place on a centralised online trading platform with straight-through-processing of clearing and settlement to complete a trade.
- Basic features of the RFQ platform:
  - System for inviting/giving quotes electronically.
  - Participants may request other participants for a quote of eligible security.
  - The quote can be placed to an identified counterparty through:
    - One To One (OTO) mode
    - One To Many (OTM) mode
  - An audit trail of all interactions, i.e. quoted yield, mutually agreed price, deal terms, etc., is maintained.
  - Negotiation is bilateral in nature.
  - Securities eligible:
    - Non-convertible securities
    - Securitized Debt Instruments
    - Municipal Debt Securities
    - Commercial Paper
    - Certificate of Deposit
    - Government Securities
    - State Development Loans
    - Treasury Bills

Circular dated 10 October 2022: Review of provisions pertaining to Electronic Book Provider Platform (EBP Platform)

SEBI, vide this circular, amended Chapter VI pertaining to the Operational Circular for the issue and listing of Non-convertible Securities (NCS), Securitised Debt Instruments, Security Receipts, Municipal Debt Securities and Commercial Paper which prescribes provisions pertaining to the EBP Platform.

The circular inter-alia provides for the following:

- The existing limit of INR 100cr in case of all prescribed types of Private Placement issuances of debt securities and Non-Convertible Redeemable Preference Shares (NCRPS) which must necessarily be made through EBP, is reduced to INR 50cr.
- The issuers of debt securities and NCRPS on a Private Placement basis of issue size less than INR 50cr (instead of INR 100cr before) are allowed to choose to access the EBP Platform for such issuances.
- The placement memorandum and the term sheet must also include the disclosure related to details of the size of the issue and green shoe portion provided that the green shoe portion shall not exceed five times the base issue size and interest rate parameter.

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- Each of the eligible participants must provide confirmation/undertaking to the EBP that it is not using any software, algorithm, bots or other automation tools, which would give unfair access for placing bids on the EBP Platform and each such EBP shall ensure that it does not provide any preferential access to any bidder on a selective basis.
- An eligible participant cannot bid for an amount more than INR 100cr or 5% of the base issue size, whichever is lower, through arranger(s) on the EBP platform except for Foreign Portfolio Investors who may bid through their custodians.
- An issuer must have the option to avail an 'anchor portion' within the base issue size, subject to fulfilment of prescribed conditions such as discretion to select an Anchor Investor (AI), the quantum of allocation to such AI not to exceed 30% of the base issue size, no bidding allowed for anchor portion, relevant disclosure to be made in placement memorandum, etc.

Circular dated 28 October 2022: Reduction in the denomination of debt securities and non-convertible preference shares

SEBI, vide this circular, amends Chapter V of the Operational Circular for the issue and listing of Non-Convertible Securities (NCS), Securitised Debt Instruments, Security Receipts, Municipal Debt Securities and Commercial Paper which prescribes provisions pertaining to the denomination of issuance and trading of NCS.

Provision:

The circular provides for face value of INR 1lac for:

- Each debt security or NCRPS issued on a Private Placement basis; and
- Listed debt security and NCRPS issued on a Private Placement basis traded on a stock exchange or OTC (Over the Counter) basis.

Applicability:

The provisions of this circular shall be applicable to all issues of debt securities and NCRPS, on a Private Placement basis, through new ISINs, on or after 01 January 2023.

With respect to a shelf placement memorandum that is valid as on 01 January 2023, the issuer shall have the option to keep the face value at INR 10Lacs or INR 1Lac while raising funds through a tranche placement memorandum.

RESERVE BANK OF INDIA ("RBI")

Appointment of Internal Ombudsman by the Credit Information Companies

The RBI vide notification dated 06 October 2022 has directed Credit Information Companies(CIC) to comply with Reserve Bank of India (Credit Information Companies-Internal Ombudsman) Directions, 2022, by 01 April 2023 including the appointment of an Internal ombudsman.

Earlier, RBI, vide Statement of Developmental and Regulatory Policies dated 05 August 2022 had called to bring credit information companies under the internal ombudsman framework to strengthen and improve the efficiency of the internal grievance redressal mechanisms of CICs.

As per the above-mentioned directions, the internal ombudsman shall be either a retired or a serving officer, not below the rank of deputy general manager or equivalent in any financial sector regulatory body, credit information company, non-banking financial company (NBFC) or bank, with necessary skills and experience of at least seven years in banking, non-banking finance, financial sector regulation or supervision, credit information, or consumer protection.

The appointment will be for a fixed term of not less than 3 years, but not exceeding 5 years.

The internal ombudsman cannot be removed before the completion of the contracted term without the RBI's explicit approval.

In case the vacancy arises on account of reasons beyond control, the credit information company shall appoint a new internal ombudsman, within three months from the date of the vacancy arising.

The RBI also said that the scope of the internal audit of credit information companies shall exclude any assessment of the correctness of decisions taken by the internal ombudsman.

The internal ombudsman shall report to the Managing Director or Chief Executive Officer administratively, and to the Board functionally.

Reserve Bank of India (Financial Statements - Presentation and Disclosures) Directions, 2021 - Disclosure of Divergence in Asset Classification and Provisioning

The RBI vide Notification dated 11 October 2022 amended the requirements with respect to the disclosure of Divergence in Asset Classification and Provisioning. The following are the key amendments:

- As per Reserve Bank of India (Financial Statements-Presentation and Disclosures) Directions, 2021, commercial banks (excluding Regional Rural Banks (RRBs)) are required to disclose details of divergence in asset classification and provisioning where such divergence assessed by the Reserve Bank of India (RBI) exceeds certain specified thresholds. In order to strengthen compliance with income recognition, asset classification and provisioning norms, RBI has decided to introduce similar disclosure requirements for Primary (Urban) Co-operative Banks (UCBs) and revise the specified thresholds for commercial banks.
- Accordingly, for the financial statements for the year ending March 31, 2023, banks shall make suitable disclosures, if either or both of the following conditions are satisfied:

REGULATORY UPDATES

- The additional provisioning for non-performing assets (NPAs) assessed by the RBI exceeds 10% of the reported profit before provisions and contingencies1 for the reference period; and
- The additional Gross NPAs identified by the RBI exceed 10% of the reported incremental Gross NPAs for the reference period.

In the case of UCBs, the threshold for reported incremental Gross NPAs specified in above shall be 15%, which shall be reduced progressively in a phased manner, after review.

The thresholds specified above shall be revised for disclosures in annual financial statements for the year ending 31 March 2024, and onwards.

Ref.	Threshold linked to:	Commercial Banks (%)	UCBs (%)
2(a)	Reported profit before provisions and contingencies	5	5
2(b)	Reported incremental Gross NPA	5	15*

*May be reduced subject to review

Diversification of activities by Standalone Primary Dealers (SPDs) - Review of permissible non-core activities - Prudential regulations and other instructions

RBI vide Notification dated 11 October 2022 has prescribed that SPDs shall adhere to prudential regulations and other instructions.

Earlier, RBI allowed SPDs to undertake foreign exchange activities as part of their non-core activities. In this connection, SPDs are required to comply with the prudential regulations and other instructions as specified in the circular and other associated guidelines applicable to SPDs.

The foreign exchange activities permitted to SPDs shall continue to be part of their non-core activity. SPDs desirous of undertaking this activity may approach the Reserve Bank of India, Foreign Exchange Department, Central Office, Mumbai for the necessary authorisation. It may be noted that in case of failure of SPDs to meet the obligations of Primary Dealership (PD) business in the Government securities market or any other violations on regulations on conducting the PD business, the Reserve Bank reserves the right to impose restrictions or withdraw permission to undertake the foreign exchange business.

The SPDs shall comply with the following prudential regulations:

- The capital charge for market risk in foreign exchange exposures shall be higher of the charges worked out by the standardised approach and the internal risk management framework-based Value at Risk (VaR) model.
- SPDs shall maintain a market risk capital charge of 15% for net open positions (limits or actual, whichever is higher) arising out of forex business with a risk weight of 100%. The net open position for foreign exchange exposures shall be calculated as prescribed.
- The capital charge for market risk shall be over & above the capital charge for credit risk of 15%.
- In addition to the foreign exchange exposure limits, the capital charge for market risk for all the permissible non-core activities, including foreign exchange activities, shall not be more than 20% of the Net Owned Fund of the SPD as per the last audited balance sheet.

SPDs shall continue to comply with the provisions of FEMA and all rules, regulations and directions issued thereunder, and also the other directions as stated in the circular to the extent applicable.

Further, RBI has permitted SPDs to take up trading and self-clearing membership with SEBI-approved stock exchanges/clearing corporations for undertaking proprietary transactions in the equity and equity derivatives market as permitted in the aforementioned Master Direction for SPDs. While doing so, SPDs shall comply with all the regulatory norms laid down by SEBI and all the eligibility criteria/rules of stock exchanges and clearing corporations.

Notification dated 11 October 2022: Multiple Non-Banking Financial Companies (NBFCs) in a Group - Classification in Middle Layer

The RBI, vide this notification, clarifies that NBFCs that are part of a common group (Group) or are floated by a common set of promoters shall not be viewed on a standalone basis and be aggregated for determination of the 'Middle Layer' status of NBFC.

If the consolidated asset size of the Group with a common set of promoters is INR 1000cr and above, each Investment and Credit Company (NBFC-ICC), Micro Finance Institution (NBFC-MFI), NBFC-Factor and Mortgage Guarantee Company (NBFC-MGC) lying in the Group shall be classified as an NBFC in the Middle Layer and accordingly relevant regulations (as applicable to Middle Layer) shall be applicable to them.

Further, the statutory auditors are required to certify the asset size of all NBFCs in the Group as on 31 March every year and the same shall be furnished to the department of supervision, RBI.

The notification is effective from 01 October 2022.

Circular dated 11 October 2022: Review of Regulatory Framework for Asset Reconstruction Companies (Revised ARC Guidelines)

RBI vide this circular has amended the revised ARC Guidelines, key highlights of which are as under:

- **Introduction of corporate governance framework:**

  Some of the measures under this category include measures to enhance ARC governance like chairing and meetings of the Board of Directors, tenure of Managing Director (MD)/Chief Executive Officer (CEO) and Whole-time Directors (WTDs) and their performance review, appropriate succession planning measures, constitution/meeting of committees of the Board and so on.

  There is a transition period of 6 months for ARCs to comply with the above-mentioned provisions.

REGULATORY UPDATES

The corporate governance measures also include fit and proper criteria test for directors and CEO, the requirement of enhanced disclosures, prior approval of RBI for change in shareholding, enhanced disclosures in the offer documents, mandatory obtaining of recovery rating from the Credit Rating Agencies (CRAs), etc.

- **Settlement of dues payable by the borrower under One-time Settlement:**

  Settlement of dues with the borrower shall be done only after the proposal is examined by an Independent Advisory Committee (IAC) which shall consist of professionals having technical/finance/legal backgrounds. The recommendations of IAC are to be deliberated by the Board of Directors and its minutes are to be maintained. Further, the settlement is to be completed only after all possible steps to recover the dues have been taken and there are no further prospects of recovering the debt. The settlement amount should preferably be paid in a lump sum and in absence of lump sum payment, IAC shall make specific recommendations about minimum upfront lump-sum payment and the maximum repayment period

- **Minimum Net Owned Fund (NOF) requirement:**

  The minimum NOF requirement is increased to INR 300cr on an ongoing basis (instead of INR 100cr). The glide path to reach to the new NOF requirement is as under.

Current Minimum NOF	INR 100cr
By 31 March 2024	INR 200cr
By 31 March 2026	INR 300cr

  Further, all the new ARC registration on and after the date of this circular must be with a minimum NOF of INR 300cr only.

- **Investment in SRs:**

  ARCs are now required to invest in the Security Receipts (SRs) at a minimum of

  - Either 15% of the transferors' investment in the SRs or
  - 2.5% of the total SRs issued, whichever is higher,

  of each class of SRs issued by them under each scheme on an ongoing basis till the redemption of all the SRs issued under such scheme.

- **Deployment of Surplus Fund:**

  ARCs are now permitted to deploy the available surplus funds in short-term instruments viz., money market mutual funds, certificates of deposit and corporate bonds/commercial papers which have a short-term rating equivalent to the long-term rating of AA- or above by an eligible CRA, subject to the prescribed conditions.

- **Allowing ARCs to function as Resolution Applicants under Insolvency and Bankruptcy, Code 2016 (IBC)**

  ARCs are now permitted to undertake the activities as a Resolution Applicant (RA) under IBC subject to the prescribed conditions, some of which are mentioned here under:

  - ARC to have a minimum NOF of INR 1000cr
  - ARC to have a Board approved policy regarding taking up the role of RA
  - A committee of Independent Directors is to be constituted to take decisions on the proposal of submission of the Resolution Plan under IBC.
  - ARCs are not to retain any significant influence or control over the corporate debtor after five years from the date of approval of the Resolution Plan.

- **Transfer of Stressed Loans to ARCs**

  All the stressed loans which are in default in the books of the transferors are permitted to be transferred to ARCs.,

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA ("ICAI")

Guidance Note on Report Under Section 92E of The Income-Tax Act, 1961 (Transfer Pricing)

The ICAI has issued a revised version of the Guidance Note on Report Under Section 92E of The Income-Tax Act, 1961 (Transfer Pricing) on 10 October 2022.

The obligation of the members of ICAI is to express an opinion on the accounts, records and documentation pertaining to international transactions and specified domestic transactions and therefore, it is expected from the members to have a thorough knowledge of transfer pricing and recent developments.

The object of this guidance note is to provide guidance to accountants in discharging their responsibilities under section 92E of the Act. It intends to:

- Assist in understanding the respective responsibilities of the taxpayer enterprise and the accountant
- Guide the accountant as to the nature and scope of information to be obtained by him from the taxpayer enterprise to enable him to conduct the examination
- Provide guidance on the verification procedures to be adopted by the accountant for giving the report and the prescribed particulars in the annexure thereto
- Explain the circumstances where a disclosure or qualification or disclaimer may be required from the accountant while giving his report.

REGULATORY UPDATES

Use of the designation "Chartered Accountant" or prefix "CA" by members while expressing views on professional/non-professional matters publicly including on social media

The ICAI has issued an Advisory dated 22 October 2022 regarding the Use of the designation "Chartered Accountant" or prefix "CA" by members while expressing views on professional/non-professional matters publicly including on social media.

The ICAI has clarified the below points with respect to the above:

- A member, whether in practice or service, may maintain an account on social networking website(s) in his personal capacity. Besides contents of personal nature, the following contents, pertaining indirectly to the member's professional domain may also be mentioned on such website(s):
  - Videos of educational nature may be uploaded on the internet by members, subject to compliance with the relevant provisions of the Code of Ethics
  - The member may post such contents on the website which help the profession grow in the perception of the world, and contributes towards the enhancement of its reputation, using expert knowledge in the respective specialization to enrich discussions, help solve problems, and promote learning and idea-sharing.

It is clarified that the members can use the prefix "CA" with their name on such social networking website(s).

- Members should exercise professional discretion and utmost dignity while using the designation of "chartered accountant" or prefix "CA" on his personal account on the social networking website(s) for posting contents/comments of the nature which do not fall above.
- As a member of the esteemed Institute, it is not appropriate to post content/comments on social networking website(s) using words/caricatures which are derogatory or not in conformity with the dignity of the profession or result in the negative portrayal of the profession. Therefore, it is advised to strictly avoid posting such content/comments with the designation of "chartered accountant" or the prefix "CA'.
- Members should comply with the provisions of Clause (2) of Part-IV of First Schedule to The Chartered Accountants Act, 1949 relating to professional misconduct of a member resulting from their action, whether or not related to professional work, bringing disrepute to the profession.

Updation of UDINs at e-filing Portal

The ICAI vide announcement dated 10 October 2022 has extended the last date till 30 November 2022 for updating the UDIN with respect to the forms filed from 01 April 2021 to 31 March 2022 in pursuance of CBDT's announcement. The members can validate their pending forms by linking them with appropriate UDINs.

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA (IBBI)

Notification dated 03 October 2022: IBBI (Model Byelaws and Governing Board of Insolvency Professional Agencies) (Amendment) Regulations, 2022. (Amended Regulations)

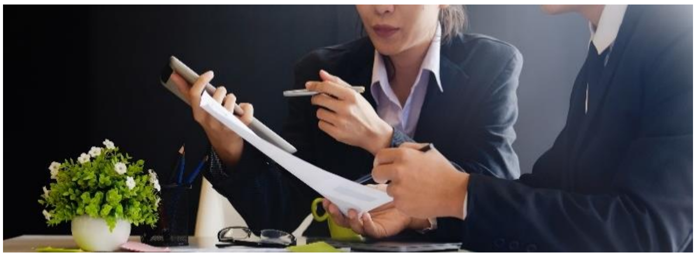
Some of the provisions of the Amended Regulations are as under:

- For an Insolvency Professional Entity (IPE) to be enrolled as a professional member, it must be eligible to be registered as an Insolvency Professional with the IBBI.
- For enrolment as a professional member, an individual or an IPE to apply in the manner, form and fees, prescribed by IBBI.
- A register of professional members maintained by IBBI must contain (amongst others) details of the partners or directors where the professional member is an IPE.

Notification dated 31 October 2022: IBBI (Model Byelaws and Governing Board of Insolvency Professional Agencies) (Second Amendment) Regulations, 2022 (Second Amended Regulations)

Some of the provisions of the Second Amended Regulations are as under:

- The compliance officer is to issue an annual compliance certificate in the prescribed format verifying that the Insolvency Professional Agency (IPA) has complied with the necessary provisions. Further, such an annual compliance certificate must also be signed by the Managing Director of the IPA.
- The IPA must facilitate receipt of relationship disclosures from its professional members and disseminate the same on its website in the prescribed format within 3 working days of its receipt.



TAX UPDATES
Direct Tax

CIRCULARS/ NOTIFICATIONS/PRESS RELEASE

The Central Board of Direct Tax (CBDT) extends the return filing due date for a certain class of taxpayers.

In respect of certain taxpayers, the due date for filing the tax return is 31 October 2022. Recently, the CBDT issued a circular extending the due date for filing income tax returns for such a class of taxpayers to 07 November 2022.

To read BDO analysis of the CBDT Circular, please visit: Direct Tax Alert - Return filing |Taxpayers - BDO

[Circular 20/2022 dated 26 October 2022]

CBDT extends the due date of filing Form 26Q for the second quarter of FY 2022-2023

With new tax withholding sections coming into effect from July 2022, Form 26Q's format has been revised and updated. This has resulted in taxpayers facing difficulties in the filing of Tax Deducted at Source (TDS) statements. Taking cognizance of the difficulties faced by taxpayers, the CBDT has issued a circular to extend the due date of filing Form 26Q for the second quarter of FY 2022-2023 from 31 October 2022 to 30 November 2022.

[Circular No. 21/2022 dated 27 October 2022]

CBDT amends the definition of 'non-reporting financial institution' for purpose of reporting under the Foreign Account Tax Compliance Act (FATCA)

CBDT has issued Income-tax (Thirty Third Amendment) Rules, 2022 to amend the definition of 'non-reporting financial institution' for purpose of reporting under FATCA. As per the amended definition, any financial institution (inter alia) that is:

- a financial institution with a local client base, in case of any U.S. reportable account
- a local bank, in case of any U.S. reportable account
- a financial institution with only low-value accounts, in case of any U.S. reportable account.

Further, the definition of Treaty Qualified Retirement Fund definition is also amended to cover only those funds that are entitled to benefits under the India-USA agreement.

[Notification No.112/2022 dated 07 October 2022]

JUDICIAL UPDATES

Lock-in listed shares cannot be treated as 'quoted shares' for the purposes of valuation under the Wealth Tax Act

- Taxpayer, an Indian Company, was a promoter of two Indian listed companies. The shares held by the Taxpayer were part of the promoter's quota and were, therefore, restricted from being traded on the stock exchange for a lock-in period of three years. The Taxpayer transferred these shares to its sister concerns, for inadequate consideration within the lock-in-period and thereby attracting provisions of the Gift Tax Act, 1958 (GT Act).
- The tax authority characterised such a transfer as a 'deemed gift' chargeable under the GT Act as the transfer was for inadequate consideration. As per the tax authority, the shares transferred were 'quoted shares' as the lock-in period of shares had not affected the transfer of shares by the Taxpayer. For this purpose, the tax authority valued such shares by treating them as 'quoted shares', notwithstanding the restrictions on transferability during the lock-in period.
- The Taxpayer contended that the valuation should be done under a prescribed break-up value method by considering the shares as 'unquoted shares', as the shares transferred were not tradeable on the stock exchange during the lock-in period. The matter travelled to the SC after passing from the appellate authority, Tribunal and Karnataka High Court.
- The SC confirming the decision of Karnataka HC ruled in favor of the Taxpayer and held that the equity shares under the lock-in period and forming part of the promoter's quota, were not 'quoted shares'. While coming to this conclusion, it observed the following:
  - Since the impugned equity shares under the lock-in period could not be traded, they did not meet the twin conditions contained in the definition of 'quoted shares', i.e. shares were not quoted on any RSE with regularity from time to time and
  - there were no current transactions made in the ordinary course of business. Accordingly, these shares remained unquoted in any RSE.
- Also, as per Securities and Exchange Board of India (SEBI) guidelines, there is a complete bar on the transfer of impugned shares during the lock-in period and this is enforced by inscribing the words 'not transferable' in the share certificate. Although, as per a general circular issued by SEBI, the shares under the lock-in period can be transferred inter-se the promoters, such restricted transfer to promoters by private transfer/sale, does not satisfy the twin conditions of 'quoted share'.

[Deputy Commissioner of Gift-tax, Central Circle-II v BPL Ltd. (Civil Appeal Nos. 3265 & 3272 OF 2016 dated 13 October 2022]

TAX UPDATES
Direct Tax

Tax Depreciation should be allowed even when the Depreciation Schedule of the Tax Return Form is not filled

Taxpayer, a Partnership Firm, in its tax return inadvertently did not feed the details of depreciation in 'Schedule DEP' and 'Part BP – Computation of income from business or profession'. However, the taxpayer had fed the depreciation figure correctly in 'Part A- P&L'. In the intimation issued under section 143(1) of the IT Act, depreciation was not allowed as a deduction though the same was added to the income from business or profession. Aggrieved, the taxpayer filed an appeal before the Commissioner of Income-tax (Appeal) who upheld the non-granting of depreciation. Hence, the taxpayer filed an appeal before the Bangalore Tax Tribunal which granted the depreciation claim. While coming to this conclusion, the Bangalore Tax Tribunal observed that:

- while depreciation figure is filled in 'Part A - Profit and Loss' and also indicated in clause 18 of Tax Audit Report 'Schedule DEP' of the Tax Return Form was left blank.
- Explanation 5 to section 32(1)(ii) of the IT Act provides that depreciation must be allowed irrespective of whether the taxpayer makes a claim for it or not.
- CBDT's Circular 14 (XI-35) of 1955, dated 11 April 1955 provides that the tax officer must not take advantage of the ignorance of the taxpayer as to his rights and that although the responsibility for claiming refunds and reliefs rests with the taxpayer on whom it is imposed by law, yet (a) the tax officer should draw the attention of the taxpayer to any refund or relief to which they are entitled to but which they have omitted to claim for some reason or other, and (b) freely advise them when approached by them as to their rights and liabilities and as to the procedure to be adopted for claiming refunds and reliefs.
- Reliance was placed on Rakesh Singh's decision[1] wherein it was held that whether the taxpayer makes a claim of depreciation or not in his return of income, the Tax Officer is duty bound to grant depreciation allowance by virtue of Explanation 5 to section 32(1) of the IT Act

  [Indauto Filters V ADIT, CPC (ITA No. 719/Bang./2022)]

SC rules on the deductibility of employees' contribution to PF/ESIC

Recently, Supreme Court had an opportunity to revisit its earlier decision dealing with the deduction of employees' contributions to the Provident Fund. It has now held that the due date for the purpose of section 36(1)(va) of the IT Act shall be the due date as per the relevant statute and not the due date of filing the tax return.

To read BDO analysis please visit: Direct Tax Alert - SC rules on deductibility of employees' contribution to PF/ESIC - BDO

[Checkmate Services P. Ltd vs CIT (Civil Appeal No. 2833 of 2016) (Supreme Court)]

SC dismisses Wipro's review petition against the earlier judgement denying to opt out of exemption under Section 10B of the IT Act

SC dismisses Wipro's review petition against the judgment denying to opt out of exemption under Section 10B of the IT Act due to non-fulfilment of mandatory twin conditions.

To read BDO analysis of the earlier judgement of SC please visit: Direct Tax Alert - Requirement of filing declaration under section 10B before due date is mandatory – BDO

[Wipro Limited V The Pr.CIT. Review Petition (C) NO.1073 OF 2022]

Equalisation Levy not attracted if the advertisers and target audiences are located outside of India

With a view to tax digital transactions, taking a cue from Base Erosion Profit Shifting Action Plan 1, the Finance Act, 2016 introduced Equalisation Levy (EL 1.0). The EL 1.0 is attracted when a non-resident taxpayer provides specified services to an Indian resident or to a non-resident having a Permanent Establishment in India. Recently, the Jaipur Tax Tribunal had an occasion to examine the applicability of EL 1.0 to a transaction where the advertisers and target audiences are located outside India.

To read BDO analysis please visit: Direct Tax Alert - Equalisation Levy not attracted if the advertisers and target audiences are locat - BDO

[DCIT-1, Jaipur vs. Prakash Chandra Mishra, ITA No. 305/JPR/2022 (Jaipur Tax Tribunal)]

Gross receipts doesn't include Service Tax for purpose of presumptive taxation under section 44BBA of the IT Act.

Recently, Chandigarh Tribunal has held that for purpose of Rule 11U, the balance sheet needn't be audited on the valuation date, provided it is subsequently audited and there are no major changes in the unaudited numbers.

To read BDO analysis please visit: Direct Tax Alert - Gross receipts doesn't include Service Tax for purpose of presumptive taxation un - BDO

[ACIT vs. M/s Cathay Pacific Airways Ltd (ITA No. 2468/Kol/2018) (Kolkata Tax Tribunal)]

[1] Rakesh Singh vs. ACIT (ITA No.1027/Bang/2011)(Bangalore Tax Tribunal)

TAX UPDATES
Transfer Pricing

A slump sale transaction between two resident group entities is not international transactional in absence of one of them being a non-resident.

During the year under consideration, the taxpayer entered into a slump sale agreement with one of its domestic-related parties. Both the taxpayer company and the domestic AE were subsidiaries of a foreign holding company. As a result, the Transfer Pricing Officer (TPO) considered the transaction of slump sale as an international transaction. This position was upheld by DRP. Further, the DRP also held that since the transaction of slump sale between two AEs was controlled by a foreign holding company i.e. a non-resident AE, it is an international transaction. Aggrieved, the taxpayer filed an appeal before the Tax Tribunal.

Tax Tribunal decision:

Mumbai Tribunal held that such slump sale transactions between two resident AEs cannot be treated as international transactions due to the below reasons:

- One of the prerequisites for a transaction to fall within the ambit of an international transaction is that it should be between two or more AEs, out of which at least one should be a non-resident. In the instant case, the transaction takes place between two resident entities.
- A bare reading of section 92B defining 'international transaction' shows that there is no such condition that the transaction between two resident companies, who are subsidiaries of a foreign holding company shall be deemed as an international transaction for the purpose of section 92C of the Act.

Thus, the Tribunal allowed the taxpayer's appeal.

MWH India Pvt. Ltd. Vs. DCIT [TS-698-ITAT-2022 (Mum)-TP]

Merely being a KMP or director does not establish that the person has a controlling interest in the entity to form AE Relationship:

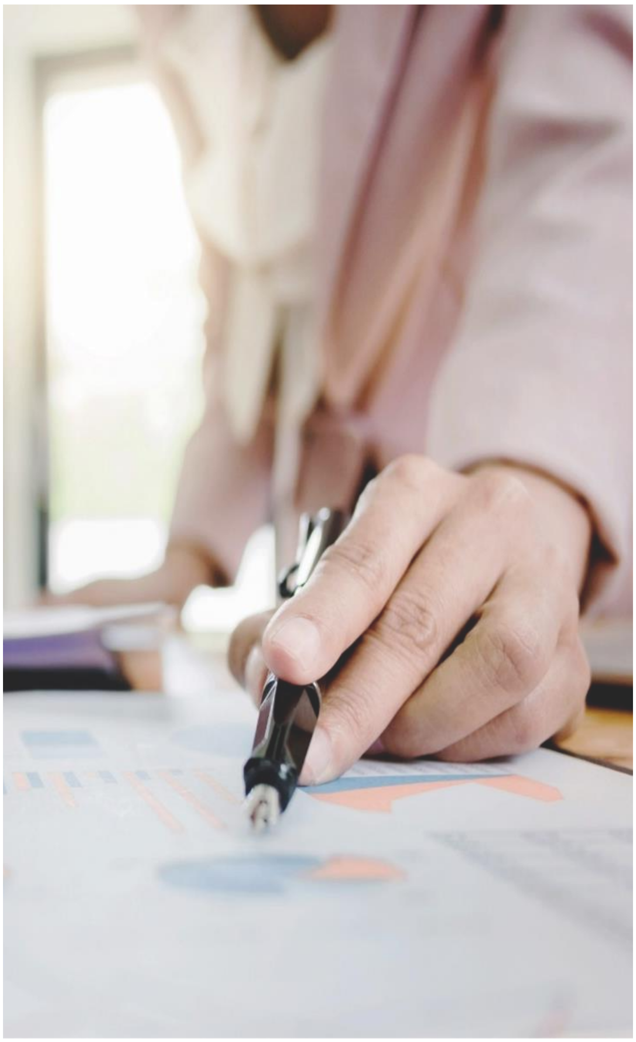
During the year under consideration, one of the directors of the taxpayer company held 91% of shares in the foreign company, while he held no shares in the taxpayer company. Since he was disclosed as a Key Managerial Person (KMP) in the audited accounts of the taxpayer company, considering Section 92A(j), TPO treated both entities as Associated Enterprises. This was upheld by CIT(A) and thus taxpayers sought relief from ITAT.

Tax Tribunal decision:

Mumbai Tribunal held that there is no AE relationship established just by virtue of the director of the taxpayer company holding 91% of the shares in the foreign company. Tax Tribunal observed that:

- Being a director in a company or even being stated to be a key managerial person does not imply that the company in question is controlled by the director.
- In order to be said to be in control of another company, as per section 92A(2)(b) and (f), either such person should hold more than 26% of the voting power of the company or such person appoints more than half of the directors or members of the governing board or one or more of the executive directors or members of the governing board. The meaning of the term 'control' in the scheme of Section 92A(2) is far more cogent than just being a 'key managerial person'. In the instant case, the facts recorded do not fulfill the above conditions to signify control over the company. As such, both entities in question cannot be treated as Associated Enterprises.

DCIT Vs. Reliance Industrial Holdings (P.) Ltd. [[2022] 144 taxmann.com 180 (Mumbai - Trib.)]



TAX UPDATES
Indirect Tax

GOODS & SERVICE TAX

JUDICIAL UPDATES

WRIT PETITION

Assessment orders passed without granting personal hearing opportunity are invalid despite the Taxpayer not opting for it

Facts of the case

- M/s. Hitech Sweet Water Technologies Pvt. Ltd.(Taxpayer) is a manufacturer of water filter machines. The taxpayer was registered under the Central Goods & Services Tax Act, 2017 (CGST Act, 2017) and was liable to file monthly returns and discharge tax accordingly.
- Taxpayer received SCN for FY 2018, FY 2019 and FY 2020 seeking demand and recovery of INR 54.67mn, INR 23.36mn and INR 13.56mn, respectively, under Section 73(9) of the CGST Act, 2017
- In reply to the SCN, the Taxpayer furnished its responses on the portal but had inadvertently failed to opt for a personal hearing.
- The Tax authority passed ex-parte orders (Impugned Orders) confirming the demand for INR 68.89mn, INR 23.66mn and INR 10.94mn for the three financial years.
- The Impugned orders were challenged by the Taxpayer before the Honorable Gujarat High Court under Article 226 of the Constitution of India.

Contentions by the Taxpayer

- The Taxpayer submitted that the Impugned orders are passed without providing an opportunity of being heard, and therefore, the same is in violation of the principles of natural justice
- While the Taxpayer did not specifically seek for a personal hearing, the same was an inadvertent mistake of the Taxpayer.
- Taxpayer is empowered to have an opportunity of being heard to enable him to address the allegations leveled against the Taxpayer in the SCNs.
- The Taxpayer inter alia relied on **M/s. Alkem Laboratories Ltd. Vs. Union of India [2021 (46) GSTL 113 (Guj.)]** and submitted that when an adverse order is passed without giving an opportunity for a personal hearing, the same is liable to be quashed.

Ruling by the High Court

- After considering the submissions put forth by the Taxpayer, the Honorable High Court set aside the Impugned orders issued by the Tax authority since the same is against the principles of natural justice and were passed without providing an opportunity of being heard.
- The Honorable High Court has directed the Tax authority to provide an opportunity of personal hearing to the Taxpayer and pass suitable orders in accordance with the law.

  [Gujarat High Court-M/s. Hitech sweet water technologies Pvt. Ltd. Vs. state of Gujarat, 2022 (10) TMI 554]

ORDERS BY AUTHORITY FOR ADVANCE RULING (AAR)

Taxability on various transactions between employer and employee and other specified transactions

Facts of the case

- M/s. RITES Limited (Taxpayer), a Government enterprise is a multi-disciplinary consultancy organisation in the field of transport, infrastructure and related technologies.
- The Taxpayer makes the following recoveries:
  - Notice pay for employee’s inability to serve the notice period
  - Bond forfeiture for premature termination of contractual employment before the expiry of the bond period
  - The nominal and subsidised amount for the meals consumed by the employees
  - Charges for loss/replacement of ID cards
  - Liquidated damages for delay in the completion of a project
  - Forfeiture of Earnest Money Deposit (EMD) and Security Deposit/Bank Guarantee
  - Amounts written off as creditors balance.

Questions before the AAR

- Whether the amount collected by the Taxpayer company as notice pay recovery from the outgoing employee would be taxable under GST law and if yes, what rate of GST thereupon
- Whether the amount of surety bond forfeited/encashed by the Taxpayer company from the outgoing contractual employee would be taxable under GST law and if yes, what rate of GST thereupon
- Whether GST would be payable on nominal and subsidised recoveries made by the Taxpayer from its employees towards the provision of a canteen facility by a third-party service provider to the Taxpayer’s employees and if yes, what rate of GST thereupon
- Whether the amount collected by the Taxpayer company from its employees in lieu of providing a new identity card (ID Card) would be chargeable to GST and if yes, what rate of GST thereupon

TAX UPDATES
Indirect Tax

- Whether the amount collected by the Taxpayer as liquidated damages for non-performance/short performance/delay in performance taxable under GST and if yes, what rate of GST thereon
- Whether the amount forfeited by the Taxpayer company pertaining to earnest money, security deposit & bank guarantee due to the reasons mentioned supra would be chargeable to GST and if yes, what rate of GST thereon
- Whether the amount of creditors balance unclaimed/untraceable and written off by the Taxpayer by way of crediting the P&L account is taxable and if yes, what rate of GST thereon

Observations and ruling by the AAR

The AAR considered all the submissions made by the Taxpayer including various judgements and circular no:178 dated 03 August 2022 and answered the questions before it as follows:

- The amount received as notice pay recovery by the Taxpayer from the employees who leave the Taxpayer company without serving a mandatory notice period which is mentioned in the employment contract is not a consideration for any supply or services. Similarly, forfeiture of a surety bond by the Taxpayer (which is furnished by the contractual employee at the time of joining) of the employees who leave the company without serving a minimum contract period as per the employment contract is not a consideration per se. These amounts are covered under Schedule III(1) and not clause 5(e) of Schedule II appended with the CGST Act, 2017. As a result, it is outside the scope of supply because the said amount recovered by the Taxpayer is in lieu of an unserved notice period/non-serving of the contract period by the employees.
- The provision of a canteen facility by the Taxpayer to its employees has no nexus with the consultancy services provided by the Taxpayer in the field of transport, infrastructure and related technologies. It proves that the canteen service is not rendered in the course of furtherance of business and held that no GST liability arises on canteen charges recovery by Taxpayer from its employees.
- The Taxpayer is not engaged in the business of printing identity cards. No third-party contractor is availed for the printing of ID cards. The ID card is re-issued in case of loss of the same or where the card is in a non-serviceable condition. In this matter, the AAR noted that the transaction does not fall under the taxable event under the GST as it is covered under Schedule III(1) appended with the CGST Act, 2017.
- The amount received as compensation for delay in the completion of work will not be taxable as it is not recovered for the supply of services to another person, and instead, it is claimed towards the damages incurred on account of delay as stipulated in the agreement. Similarly, forfeiture of EMD/security deposit/bank guarantee cannot be chargeable to tax.
- Amounts written off in the books of accounts cannot be regarded as the amounts received for supplying goods/services. Therefore, write-off entry merely amounts to writing off its outstanding expenses, (i.e. amount outstanding against services or goods received by the Taxpayer) in books of accounts as not payable in the future. As a result, writing off the unclaimed amount of the contractors/other creditors is basically an income and not a supply, and hence, outside the purview of supply under the CGST Act, 2017.

[AAR-Haryana, M/s. RITES Limited, Ruling no:HR/ARL/19/2022-23, dated 18 October 2022]

FOREIGN TRADE POLICY

FTP benefits are in the form of incentives, they cannot be claimed as a matter of right

Facts of the case

- Chowgule & Company Limited (Taxpayer) is engaged in the export of processed iron ore and is a recognised trading house.
- Under the Exim Policy 1988-1991, there was a provision for 'additional license' and a trading house would be eligible for an 'additional license' on the basis of the admissible exports in the preceding licensing year. Para 212 of the Exim Policy 1988-1991 stipulated that the computation of Net Foreign Exchange Earnings (NFE) would exclude earnings from the export of items specified in Appendix 12 (which included 'Minerals and ores – unprocessed').
- However, in 1990, a new Exim Policy was introduced, viz. Exim Policy, 1990-93. There was an amendment in Appendix 12 and the entry 'Minerals and ores – unprocessed' was replaced by 'Minerals and ores'.
- In terms of the Exim Policy 1988-1991, the Taxpayer entered into a contract with one NKK Corporation, Japan, for the export of processed iron ore, an eligible item for NFE computation under Exim Policy 1988-1991 but ineligible under Exim Policy 1990-1993. The Taxpayer also exported the said goods between April 1990 to March 1991 when Exim Policy, 1990-1993 was in force.
- In respect of the aforesaid exports, the Taxpayer had filed an application for the grant of additional licenses, which have been through a series of litigations. The latest order was the order of the Honorable Bombay High Court whereby the Writ petition filed by the Taxpayer was dismissed on the ground that under the Exim Policy 1992-1993, 'processed iron ore' was ineligible for NFE computation and grant of additional license.
- Aggrieved by the impugned judgment and order passed by the High Court, the Taxpayer preferred an appeal before the Honorable Supreme Court of India.

TAX UPDATES
Indirect Tax

Contention by the Taxpayer

- The Taxpayer submitted that the issue essentially is with regard to the Taxpayer's claim for grant of 'additional license' under the Exim Policy 1988-91 based on eligible export of 'processed iron ore' in the preceding years.
- It is also submitted that they acted upon the Exim Policy 1988-91 and incurred commercial and financial commitments severely, altering its position to its serious detriment. The Taxpayer exported the 'processed iron ore' in the year 1989-91.
- It was further submitted that applying the doctrine of promissory estoppel, the Taxpayer shall be entitled to the benefit of a grant of additional license on the export of the 'processed iron ore'. It was also submitted that price negotiation also factored the incentive of additional license which was in force during the time of entering into the agreement.
- Taxpayer also contended that the benefit of an additional license was granted to several other exporters, and the action of DGFT in denying the additional license to the Taxpayer on the export of 'processed iron ore' would be discriminatory and violative of Article 14 of the Constitution of India.

Contentions by the Director General of Foreign Trade (DGFT)

The DGFT has made the following contentions:

- The denial of the additional license is absolutely in consonance with the Exim Policy 1990-93.
- It was submitted that the Taxpayer actually exported the 'processed iron ore' post-April 1990.
- It was also submitted that under the Exim Policy 1990-93, as per Appendix 12, 'processed iron ore' was in the excluded category and in the category of ineligible items and the additional licenses were available only on export in the preceding years of eligible items.
- On replying to the Taxpayer's submission on 'promissory estoppel' the DGFT submitted that the benefit of additional license was in the form of an incentive and the same cannot be claimed as a matter of right. It was submitted that being a policy decision, it is always open to the department/DGFT to come out with a modified/fresh/new Exim Policy and hence, the principle of promissory estoppel shall not be applicable at all.

Observations and Ruling by the Court

The Court has made the following observations and ruling:

- The Taxpayer was claiming the benefit of an additional license on the export of 'processed iron ore' exported during the Exim Policy 1990-93.
- Under the Exim Policy 1990-93, 'Minerals and Iron Ore' are included in the list of ineligible items. As per Exim Policy 1988-1991, only the export of 'unprocessed iron ore' was ineligible to get the benefit of an additional license.
- The Taxpayer had actually exported 'processed iron ore' during the period April 1990 to March 1991, which was under the regime of the new Exim Policy 1990-93.
- The Court is of the opinion that the Taxpayer has been denied the benefit of an additional license as the export of 'Minerals and Iron Ore' is an ineligible item under the new Exim Policy 1990-93.
- The Taxpayer is claiming the benefit of an additional license under the Exim Policy 1988-91 on the ground of promissory estoppel. However, when the new Exim Policy 1990-93 is applicable which denies the benefit of additional license on the export of 'Minerals and Iron Ore', the Taxpayer cannot be permitted to be granted an additional license under an earlier Exim Policy, not in existence.
- The benefit of an 'additional license' is in the form of an incentive. The DGFT is free to change the Exim Policy and re-consider items on which incentive would or would not be granted. To grant such a benefit is a policy decision that may be varied and/or even withdrawn. No exporter can claim the incentive as a matter of right. The doctrine of promissory estoppel shall not be applied to such a policy decision with respect to incentive, more particularly when it is well within the right of DGFT/appropriate authority/Union to come out with a new Exim Policy.
- Under the circumstances, the fact that the Taxpayer placed the order with NKK Corporation, Japan when the Exim Policy 1988-91 was in force, and therefore, the Taxpayer would be entitled to additional license by applying the doctrine of promissory estoppel cannot be accepted. The policy and the incentive scheme are very clear. Incentive in the form of an additional license is on actual exports made during the previous year.
- As regards the Taxpayer's submission that similar benefits have been allowed in the case of other exporters, it was held that merely because some others are granted the benefit wrongly, the appellant cannot be permitted to pray for similar benefits. There cannot be any negative discrimination that may perpetuate the illegality.
- In view of the above, the Honorable Supreme Court concluded that the High Court has rightly confirmed the order passed by the authority denying the benefit of additional license to the Taxpayer.

[Supreme Court of India, Chowgule & Company Limited Vs Assistant Director General of Foreign Trade & Others, Civil Appeal no:8225 OF 2009 dated 04 November 2022]

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