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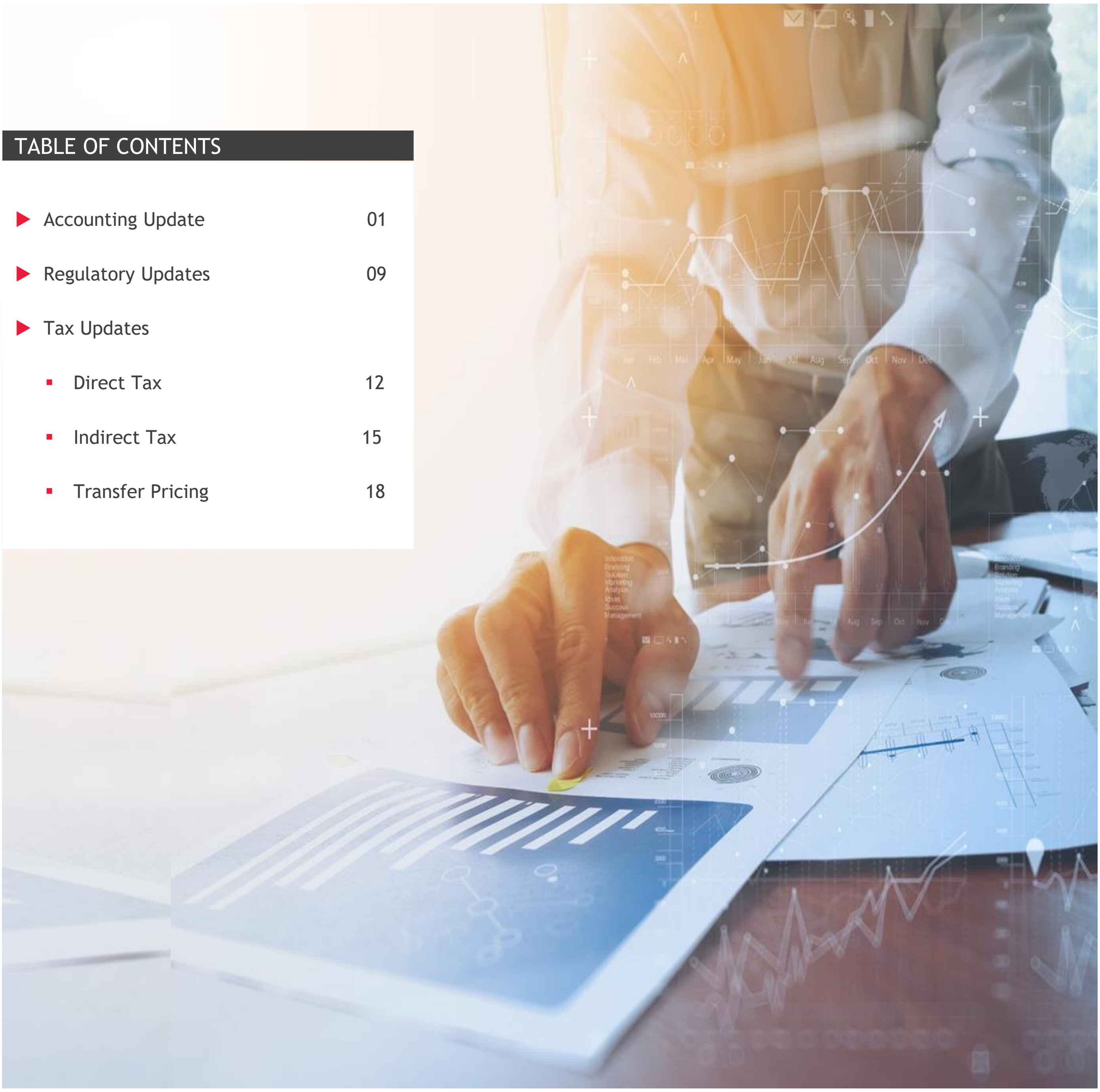

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ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

EAC OPINION

CLASSIFICATION OF PPE UNDER REFURBISHMENT, DEPRECIATION THEREON AND ITS IMPAIRMENT

Facts of the Case:

A Company is a Central Public Sector Undertaking in India under the administrative control of the Department of Fertilizers, Ministry of Chemicals and Fertilizers. The Company was incorporated as a joint venture between the Government of India (GOI) and ABC India Incorporation of USA with the GOI holding 51% of the equity share capital. The Company is engaged in the manufacture of ammonia, urea and complex fertilizers.

The production units of Company consist of Ammonia and Urea in single stream and Nitrogen, Phosphorus & Potassium (NPK) in 3 streams, viz. NPK A Train, B Train and C Train.

The Company has stated that NPK A, B and C trains of the Company have an installed capacity of 2.8lahks Metric Tonnes per Annum (MTPA) each. NPK A and B trains which have an installed capacity of 5.6lakhs MTPA are not in operation since 2005 (i.e. more than 15 years) due to technical issues, non-availability of raw materials and shortage of manpower. Currently, they are not in immediate use condition due to technical obsolescence arising from a change in the production process.

As per the Company's accounting policies, the estimated useful life of the plant and machinery is 25 years. Post-revamp, the NPK A and B trains are used hardly for 7 years and thereafter they became idle. Accordingly, the Board of Directors of the Company has made the revision of the installed capacity of NPK A, B and C from 8.4lahks MTPA to 2.8lahks MTPA, by making a note as under:

> *" Further, both the trains of A & B are not in line for more than 15 years and are not in immediate use condition. Hence until these trains are revived for usability, it is proposed to revise the Installed Capacity of NPK Complex from 8.4 lakh MTPA to 2.8 lakh MTPA taking into account only the Train C which is in operation."*

The Company has further stated that the Company has a plan of refurbishing the NPK A and B trains in order to bring the viability of the said trains. In the financial statements of the Company for the year ended 31 March 2021, consequent to the Board approval, the Company has withdrawn the assets belonging to NPK A and B trains from the Property, Plant and Equipment (PPE) with effect from 01 April 2020, and classified under Capital Work In Progress (CWIP). The same will be re-inducted to PPE once these are refurbished and in ready-to-use condition.

Due to the classification of assets of NPK A and B train from PPE to CWIP, the Company has ceased the depreciation of the said assets from 01 April 2020, onwards.

The carrying cost of assets in the NPK A and B trains as on 31 March 2020 is INR 2.22cr, which has been classified as CWIP in the financial statements of the Company for the year ended 31 March 2021.

During audit of the annual accounts of the Company for the financial year (FY) 2020-21, the Comptroller and Auditor General of India (C&AG) has made a provisional comment on the said classification, which is reproduced below:

"1.5 Assets- Property Plant and Equipment – INR 188.39cr

Reference is invited to Note No. 30.6 attached to and forming part of Standalone Ind AS Financial Statements for the year 2020-21, wherein it was stated that the Company removed Trains A and B of NPK plant from 'Property Plant and Equipment' as the assets are not in operation since 2005. The Board of Directors in their 314th Meeting held on 9 November 2020, revised the installed capacity of the NPK plant from 8.40 lakh MT per annum to 2.80 lakh MT

per annum until these trains are revived for usability. On the basis of the above, Board decision dated 9 November 2020, the carrying cost (Net Assets Value) of these assets as of 01.04.2020 (INR 2.22cr) is reclassified under 'Capital Works in Progress' and therefore the Company did not provide for depreciation on the assets during 2020-21.

According to Indian Accounting Standard (Ind AS) 16, depreciation does not cease when an asset is idle or retired from use for sale (unless it is fully depreciated). Further, there is no provision in Ind AS to transfer a PPE to CWIP. As such, transferring the Trains A and B of the NPK plant to CWIP and failure to provide depreciation is in contradiction to Ind AS.

This has resulted in understatement of Property, Plant and Equipment by INR 1.46cr and understatement of depreciation by INR 0.76cr with the corresponding overstatement of capital work in progress by INR 2.22cr."

Reply to C&AG by Company:

The reply of the Company as submitted to the C&AG is as under:

"The Board of Directors in their 314th Board Meeting revised the installed capacity of NPK production from 8.40 lakh MTPA to 2.80 lakh MTPA by withdrawing NPK A & B Plant from an operation.

Further, it is decided to operate the NPK A & B Train after refurbishing.

Ind AS is not specifically mentioning any accounting treatment for transfer from PPE to CWIP.

NPK A and B Plant are withdrawn from operation temporarily, hence, the same cannot be classified under PPE. Further, the assets are not scrapped, only withdrawn for refurbishment and subsequent use. The refurbishment expenditures are in capital nature. Hence the withdrawn assets are reclassified as CWIP.

The NPK A and B Plant were not in use since 2005 and hence were transferred to CWIP during the year and hence it was decided not to provide depreciation during the year."

Reply by the Statutory Auditors of the Company:

Further, the statutory auditors of the Company have supplemented the reply made by the Company which is as follows:

"To Supplement, attention is invited to paragraph 67 of Ind AS 16, which states that the carrying amount of an item of property, plant and equipment shall be derecognised either on disposal or when no future economic benefits are expected from its use or disposal. Accordingly, the two assets namely NPK A & B Trains are not in active use since 2005 and no economic benefits accrue to the Company. These are therefore rightly removed from the PPE.

As per Ind AS 105, 'Non-Current Assets Held for Sale and Discontinued Operations', the carrying amount of property, plant and equipment retired from active use is to be classified as held for sale only when the intention of the management is to dispose of the assets within the stipulated time schedule. But it is clear from the resolution passed in their 314th Board Meeting held on 9 November 2020, that the management has decided to revive the assets for usability. Since the intention is not to sell, grouping under 'Assets Held for Sale' does not arise.

In the absence of any specific date adopted by the Board for reclassification of the asset, it was presumed that the de-recognition of NPK train A & B and depreciation thereon will cease from 01st April 2020, due to non-operation of said trains from 2005 onwards.

Being non-current assets, Ind AS 1, 'Presentation of Financial Statements' permits grouping under alternative description as long as the intention of the management is clear. Paragraph 67 of Ind AS 1 is reproduced below for ready reference:

"67 This Standard uses the term 'non-current' to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear."

In view of the above, the classification done by the Company as permitted by Ind AS 1 is more appropriate and justified."

The C&AG has not dropped the observation based on the reply submitted by the Company and statutory auditors. They retained the comment under section 143(6)(b) of the Companies Act, 2013 on the accounts of the Company for the year ending 31 March 2021, which is as reproduced below:

"A. Comments on Financial Position:

Assets

Capital Work in Progress: INR 17.78cr. (Note-2.2)

The above includes an amount of INR 2.22cr being the net carrying value of Train 'A' and 'B' of NPK Plant due to derecognition of these assets from 'Property, Plant and Equipment (Note-2)'. These assets were not in operation since the year 2005. These assets were not scrapped and were only withdrawn for refurbishment and subsequent use. No depreciation was charged by the Company on these assets during 2020-21. The company revised the installed capacity of NPK Plant from 8.40lakh MT per annum to 2.80lakh MT per annum until these trains of NPK Plant are revived for usability.

Ind AS 16 states that depreciation does not cease when an asset is idle or retired from active use unless the asset is fully depreciated. Further, other factors such as technical or commercial obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefit that might have been obtained from the asset. Thus, the de-recognition of assets from 'Property, Plant and Equipment' and accounting for these under 'Capital Work in Progress' and non-provision of depreciation on such assets, is not in compliance with provisions of Ind AS.

This has resulted in an understatement of the net carrying value of 'Property, Plant and Equipment' by INR 1.46cr, an understatement of 'Depreciation' for the year by INR 0.76cr with a corresponding overstatement of 'Capital Work in Progress' by INR 2.22cr."

Query

On the basis of the above, the opinion of the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI) has been sought by the Company on the following issues:

-) Whether accounting treatment followed by the Company with reference to classification from PPE to CWIP and cessation of depreciation is correct and in accordance with Ind AS.
- (ii) In case the accounting treatment followed by the Company is correct, then how the presentation of CWIP is to be made in accordance with Schedule III to the Companies Act, 2013, as amended by MCA Notification dated 24 March 2021
- (iii) In case the assets are to be shown under PPE, whether an impairment is to be recognised.

Points considered by the Committee

The Committee notes that the basic issue raised in the query relates to the classification of PPE under refurbishment, depreciation thereon and its impairment. The Committee has, therefore, considered only this issue and has not examined any other issue.

The Committee notes from the Facts of the Case that the Company has stated that NPK A and B plants/trains are not in operation for more than 15 years due to technical issues, non-availability of raw materials and shortage of manpower and currently, are not in immediate use condition due to technical obsolesce arising from a change in the production process. The Company now has a plan of refurbishing the NPK A and B trains in order to bring the viability of the said trains. Therefore, the Company has withdrawn the assets belonging to NPK A and B trains from the Property, Plant and Equipment (PPE) with effect from 01 April 2020, and classified under Capital work in progress (CWIP). As per the Company, the same will be re-inducted to PPE once these are refurbished and in ready-to-use condition. Further, due to the classification of the assets of NPK A and B train from PPE to CWIP, the Company has ceased the depreciation of the said assets from 01 April 2020, onwards.

At the outset, the Committee notes that a non-current asset is to be classified as held for sale as per Ind AS 105 if its carrying amount will be recovered principally through a sale transaction rather than through continuing use. Therefore, NPK A and B plants, whose carrying amount shall be recovered through continuing use although after refurbishment, cannot be considered as non-current assets (or disposal group) held for sale and accordingly, the requirements of Ind AS 105 are not applicable in the extant case.

Further, the refurbishment cost on the existing plants, being in the nature of subsequent cost/expenditure, the Committee notes the following requirements of Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment', in respect of subsequent costs:

"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. The cost of an item of property, plant and equipment may include costs incurred relating to leases of assets that are used to construct, add to, replace part of or service an item of property, plant and equipment, such as the depreciation of right-of-use assets."

"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 the 'repairs and maintenance' of the item of property, plant and equipment.

13 Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be acquired to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a nonrecurring replacement. Under the recognition principle in paragraph 7, an entity recognises in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced are derecognised in accordance with the derecognition provisions of this Standard (see paragraphs 67–72).

14 A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed."

From the above, the Committee notes that in case of subsequent expenditure involving replacement or major inspections/servicing/repair of an item of PPE, where such subsequent expenditure meets the recognition principle in paragraph 7 of Ind AS 16, the Standard only requires to derecognise the carrying amount of previous inspection cost or existing item or part of PPE being replaced or as per the requirements of paragraphs 67 to 72 and nowhere requires to transfer or classify such an item of PPE on which subsequent expenditure is being incurred as 'capital work in progress' or any other classification.

The Committee further notes the following paragraphs of Ind AS 16 relating to derecognition of PPE:

"67 The carrying amount of an item of property, plant and equipment shall be derecognised:

"67 The carrying amount of an item of property, plant and equipment shall be derecognised:

- on disposal; or
- when no future economic benefits are expected from its use or disposal.

68 The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in profit or loss when the item is derecognised (unless Ind AS 116, Leases, requires otherwise on a sale and leaseback). Gains shall not be classified as revenue."

"69 The disposal of an item of property, plant and equipment may occur in a variety of ways (eg by sale, by entering into a finance lease or by donation). The date of disposal of an item of property, plant and equipment is the date the recipient obtains control of that item in accordance with the requirements for determining when a performance obligation is satisfied in Ind AS 115. Ind AS 116 applies to disposal by a sale and leaseback."

From the above, the Committee notes that an item of PPE shall be derecognised only on disposal or when no future economic benefits are expected from its use or disposal. However, in the extant case, the Company intends to re-induct the plants after refurbishment and thus, it cannot be considered that no future economic benefits are expected from their use (though after refurbishment only). Further, since there is no disposal of the plants, the Committee is of the view that the said items of PPE cannot be derecognised and these should continue to be recognised as PPE in the financial statements.

With regard to the cessation of depreciation, the Committee notes the following paragraphs from Ind AS 16:

"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.

56 The future economic benefits embodied in an asset are consumed by an entity principally through its use. However, other factors, such as technical or commercial

obsolescence and wear and tear while an asset remains idle, often result in the diminution of the economic benefits that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:

- expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
- expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.
- technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits embodied in the asset.
- legal or similar limits on the use of the asset, such as the expiry dates of related leases."

From the above, the Committee notes that considering that Ind AS 105 is not applicable in the extant case, as discussed above, depreciation of the plants should cease only on the date the plants are derecognised. However, since derecognition conditions as per Ind AS 16 are not fulfilled in the extant case, the depreciation on this ground also should not cease. This is also supported by the requirements of paragraph 55 of Ind AS 16, which specifically states that depreciation does not cease when the asset becomes idle or is retired from active use, (which appears to be the situation in the extant case) unless the asset is fully depreciated. Further, the Standard also states that technical or commercial obsolescence and wear and tear while an asset remains idle, also result in the diminution of the economic benefits and useful life of an asset and therefore, depreciation should be provided considering these factors as well.

With regard to impairment, the Committee notes the following requirements of Ind AS 16 and Ind AS 36, 'Impairment of Assets':

Ind AS 16

"Impairment

63 To determine whether an item of property, plant and equipment is impaired, an entity applies Ind AS 36, Impairment of Assets. That Standard explains how an entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises, or reverses the recognition of, an impairment loss."

Ind AS 36

"9 An entity shall assess at the end of each reporting period whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset."

"12 In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:

…

(e) evidence is available of obsolescence or physical damage of an asset.

(f) significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite. …"

"17 If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortisation) method or the residual value for the asset needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognised for the asset."

The Committee notes that Ind AS 36 does not make any exception for the asset being idle or retired from active use. Further, the availability of evidence of any obsolescence or the asset becoming idle or plans to restructure provides an indication of impairment. Since in the extant case, the assets (NPK A & B plants/trains) are not in operation for more than 15 years due to various technical issues and are not in immediate use condition due to technical obsolescence arising from a change in the production process, the Committee is of the view that these provide an indication that these assets may be impaired. Therefore, the same should be assessed by the Company for impairment of assets, as per the requirements of Ind AS 36. Further, these factors may also provide an indication of the revision of the useful lives of these assets, determined as per the requirements of Ind AS 16.

Opinion

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

- The accounting treatment followed by the Company with regard to the classification of PPE under refurbishment as CWIP and cessation of depreciation is not correct as discussed above.
- In view of (i) above, the answer to this question does not arise.

- Since in the extant case, the assets (NPK A & B plants/trains) are not in operation for more than 15 years due to various technical issues and are not in immediate use condition due to technical obsolescence arising from a change in the production process, these provide an indication that these assets may be impaired. Therefore, the same should be assessed by the Company for impairment of assets, as per the requirements of Ind AS 36, as discussed above.

REGULATORY UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

IMPLEMENTATION GUIDE TO STANDARD ON AUDITING (SA) 230 AUDIT DOCUMENTATION (REVISED 2022 EDITION)

Standard on Auditing (SA) 230, 'Audit Documentation' prescribes the basic principles of audit documentation. These principles need to be followed by auditors while complying with requirements of SA 230 and specific documentation requirements of other Standards on Auditing. In 2013, the Auditing and Assurance Standards Board (AASB) of ICAI issued the 'Implementation Guide to SA 230, Audit Documentation' to provide practical implementation guidance to auditors on this Standard. The Implementation Guide was revised in 2018. Suggestions were received from some stakeholders that more guidance on the aspect of assembly of the final audit file may be included in the Implementation Guide. Based on these suggestions, AASB decided to revise the Implementation Guide.

On 06 December 2022, a revised edition of the Implementation Guide to SA 230 has been issued which contains a Summary of the Standard, Introduction, FAQs on SA 230, Checklist and Illustrative Working Paper Format. Chapter 3: FAQs on SA 230 of a revised edition of the Implementation Guide contains detailed guidance on the principles of SA 230 in a Question-Answer format.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

FRAMEWORK FOR ORDERLY WINDING DOWN OF CRITICAL OPERATIONS AND SERVICES OF A CLEARING CORPORATION

The SEBI vide circular dated 16 December 2022, has decided that Clearing Corporations (CCs) shall have a policy framework for the Orderly Winding Down of Critical Operations and Services which shall contain some specific provisions as laid down in the circular. The following are key provisions to be included in the framework:

- Under the framework, CCs will have to draw up a Standard Operating Procedure (SOP) outlining the manner in which their critical services would be carried out in an orderly manner so as to not cause any disruption to the financial system, upon triggering of any of voluntary or involuntary winding down of operations. The SOP shall include details of infrastructure & premises, technological systems including backup and outsourcing activities which would need to be retained or continued for the orderly winding down of critical operations and services. A notice or intimation regarding the winding down of critical operations and services shall be issued by the CC as and when the scenarios get triggered, with prior approval of SEBI.
- As per the circular, scenarios that may potentially prevent a clearing corporation from being able to provide its critical services and may lead to the winding down of its critical operations and services shall be identified. The reasons for winding down of CC can be voluntary or involuntary. Involuntary winding down would depend on factors such as regulatory action, losses due to default by clearing members and losses due to other factors like some large operational expenses, legal expenses or investment losses.
- As per the regulatory requirements, a CC would be required to continuously meet the annual clearing turnover of at least INR 1,000cr/annum. In case the CC fails to meet the requirement for 2 consecutive years, it will be liable to exit and accordingly, apply for an orderly winding down of its critical operations and services. The threshold condition would not be applicable to a CC for a period of 5 years from the date of the grant of recognition. In a case where the CC does not apply for voluntary winding down after breaching the minimum turnover threshold, Sebi may proceed with compulsory derecognition of such CC under applicable laws.
- Quantum of assets available for distribution would be arrived at after payment of statutory dues, including applicable taxes and contribution to the regulator, return of refundable collateral and membership deposits of clearing members (CMs), return of deposits to warehouse service providers, if any, and the unutilised Core SGF contributions of CMs and stock exchanges. Subsequent to exit, the CC would also be required to contribute up to 20% of its assets towards Sebi Investor Protection and Education Fund (IPEF) in order to provide for the settlement of any claims pertaining to pending arbitration cases, unresolved complaints or grievances lying with the CC.
- The regulatory oversight committee (ROC) of the CC would oversee the implementation of processes involved in the orderly winding down of critical operations and services and would submit a report to SEBI.

CCs shall have the policy framework containing the SOP duly approved by their governing boards and make it available on their websites within 90 days from the date of issuance of this circular.

RESERVE BANK OF INDIA ("RBI")

REVIEW OF NORMS FOR CLASSIFICATION OF URBAN CO-OPERATIVE BANKS (UCBS) AS FINANCIALLY SOUND AND WELL MANAGED (FSWM)

The RBI vide circular dated 01 December 2022, has prescribed revised norms to categorise UCBs as Financially Sound and Well Managed (FSWM) banking entities to enhance the profile of urban cooperative banks (UCBs). These norms are applicable with immediate effect.

For categorising themselves as FSWM category banks, the following conditions need to see:

- The Capital to Risk-Weighted Assets Ratio (CRAR) should be atleast 1% cent above the minimum CRAR applicable to a UCB as of the reference date.
- Net non-performing Assets (NPAs) should not be more than 3%.
- They should have reported a Net profit for at least 3 out of the preceding 4 years. They should not have incurred a net loss in the immediate preceding year.
- The banking regulator has put emphasis on the liquidity status of banks. The bank should not have defaulted on maintaining its Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) during the preceding year.
- The bank should have a sound internal control system with at least 2 professional directors on the board and a fully implemented core Banking Solution (CBS).
- Also, no monetary penalty should have been imposed on the bank for violation of RBI's directives and guidelines during the last 2 financial years.

UCBs can decide the eligibility to be classified as an FSWM under the revised criteria based on the assessed financials and findings of the RBI inspection report or audited financial statements, whichever is the latest.

The boards of the banks have to examine compliance with the FWSM criteria and pass necessary resolutions and inform RBI immediately. Definitely, it should not be later than within 15 calendar days from the date of passing the resolution.

UCBs may review the compliance with FSWM criteria every year at the Board level immediately after the audit of the financial statements and RBI inspection report as and when received. This process will be subject to supervisory review.

OPERATIONS OF SUBSIDIARIES AND BRANCHES OF INDIAN BANKS AND ALL INDIA FINANCIAL INSTITUTIONS (AIFIS) IN FOREIGN JURISDICTIONS AND IN INTERNATIONAL FINANCIAL SERVICES CENTERS (IFSCS) - COMPLIANCE WITH STATUTORY/REGULATORY NORMS

The RBI vide notification dated 01 December 2022, has issued directions to allow Subsidiaries and Branches of Indian Banks operating outside India to undertake activities that are not specifically permitted in the Indian domestic market.

The foreign branches/foreign subsidiaries of Indian banks/AIFIs can deal in financial products, including structured financial products, which are not available or are not permitted by the Reserve Bank in the domestic market without prior approval of the Reserve Bank, subject to compliance with specific conditions specified in these directions and those prescribed by the host regulator.

Similar permission has been granted to branches and subsidiaries of Indian banks/ AIFIs operating in IFSCs including those operating out of GIFT City.

While allowing branches/ subsidiaries in foreign jurisdictions as well as in IFSCs to deal in such products, the parent Indian bank/AIFI shall ensure that:

- Dealing with such products is done with prior approval from their Board and, if required, the appropriate authority in the concerned jurisdictions.
- They have adequate knowledge, understanding and risk management capability for handling such products.
- They act as market makers for products only if they have the ability to price/value such products and the pricing of such products is demonstrable at all times.
- Their exposure and mark-to-market (MTM) on these products are appropriately captured and reported in the returns furnished to the Reserve Bank. They shall provide information about dealing in such financial products as may be specified by the Reserve Bank in the manner and format and within the time frame as prescribed by the Reserve Bank.
- They do not deal in products linked to Indian Rupee unless specifically permitted by Reserve Bank.
- They do not accept structured deposits from any Indian resident.

- They adhere to the suitability and appropriateness policies as mandated by the Reserve Bank and the host regulators, as applicable.

These directions are applicable to all banks regulated by the Reserve Bank (excluding co-operative banks, Regional Rural Banks and Local Area Banks) and AIFIs. They shall come into force with immediate effect.

STANDING LIQUIDITY FACILITY FOR PRIMARY DEALERS

The RBI has issued a notification dated 07 December 2022, to increase the policy repo rate under the Liquidity Adjustment Facility (LAF) by 35 basis points from 5.90% to 6.25% with immediate effect as per the Monetary Policy Statement 2022-23.

Accordingly, the Standing Liquidity Facility provided to Primary Dealers (PDs) (collateralised liquidity support) from the Reserve Bank would be available at the revised repo rate of 6.25% with immediate effect.

LIQUIDITY ADJUSTMENT FACILITY- CHANGE IN RATES

The RBI has issued a notification dated 07 December 2022, to increase the policy repo rate under the Liquidity Adjustment Facility (LAF) by 35 basis points from 5.90% to 6.25% with immediate effect as per the Monetary Policy Statement.

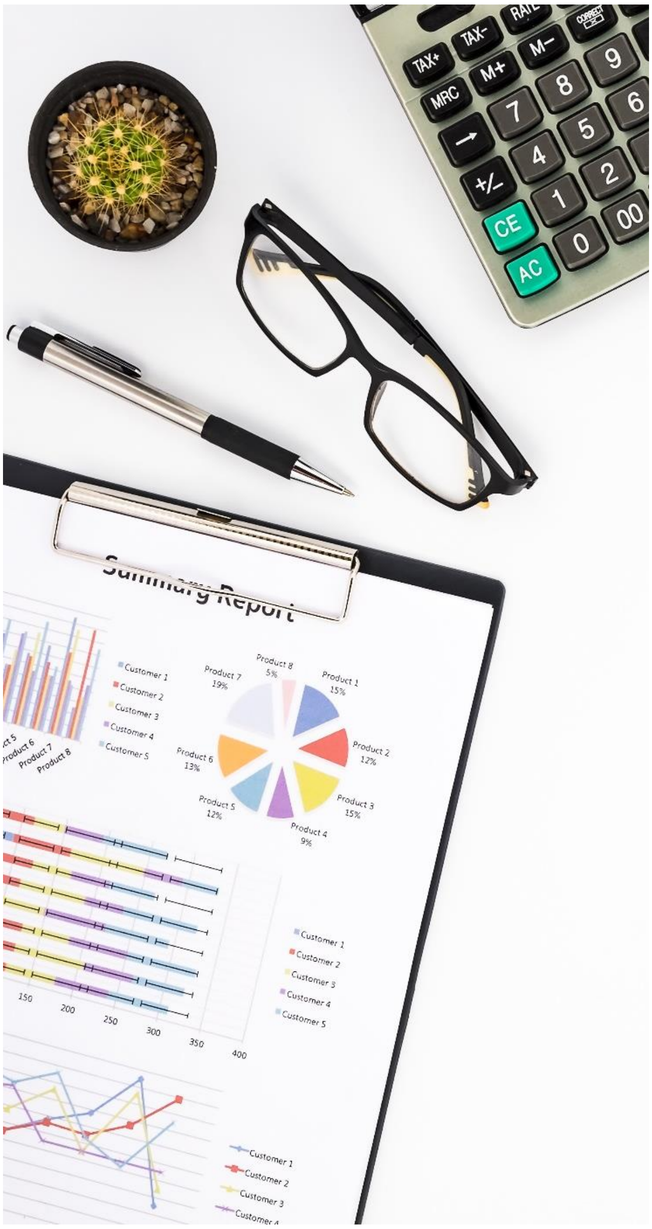
Consequently, the standing deposit facility (SDF) rate and marginal standing facility (MSF) rate stand adjusted to 6.00% and 6.50% respectively, with immediate effect.

Sovereign Gold Bond (SGB) Scheme 2022-23

The RBI vide notification dated December 16, 2022 has announced Series III and IV of Sovereign Gold Bond Scheme 2022-23. Under the Scheme, there will be a distinct series (Series III and IV) for every tranche. The terms and conditions of the issuance of the Bonds shall be as per the notification.

The bonds shall be issued as per the details given below:

Sno	Tranche	Subscription date	Issuance date
1.	2022-23 Series III	19 December – 23 December 2022	27 December 2022
2.	2022-23 Series IV	06 March – 10 March 2023	14 March 2023



REGULATORY UPDATES

MINISTRY OF CORPORATE AFFAIRS (MCA)

CLARIFICATION DATED 28 DECEMBER 2022: CLARIFICATION ON HOLDING OF ANNUAL GENERAL MEETING (AGM) THROUGH VIDEO CONFERENCE (VC) OR OTHER AUDIO-VISUAL MEANS (OAVM)

MCA permits companies to conduct their AGM, which was due to be held in the year 2023, on or before 30 September 2023.

MCA has further clarified that the above shall not be construed as an extension of time for holding of AGMs as per the Companies Act, 2013 and not adhering to timelines would attract legal action.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

OPERATIONAL CIRCULAR DATED 01 DECEMBER 2022: LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS FOR NON-CONVERTIBLE SECURITIES (NCS), SECURITISED DEBT INSTRUMENTS AND/OR COMMERCIAL PAPER (LISTING REGULATIONS)

For effective regulation of the corporate bond market and to enable the issuers/other stakeholders to get access to all the applicable circulars at one place, SEBI has come up with this Operational Circular which is a chapter-wise compilation of all the relevant existing circulars relating to the Listing Regulations, with consequent changes.

The Circular provides for:

- Formats for filing of financial information, audit report, a statement indicating deviation/variation in utilisation of listed NCS issue proceeds and disclosures with respect to audit qualifications, defaults in payment of interests/loans availed from banks, etc.
- Requirements that a listed entity must comply with if it has issued Non-Convertible Securities (NCDs) and/or Non-Convertible Redeemable Preference Shares (NCRPS) vide a scheme of arrangement in lieu of its listed specified securities (i.e. equity shares and convertible securities) and such NCDs and/or NCRPS are proposed to be listed along with necessary formats.
- Regulatory aspects and formats relating to corporate governance compliance report, secretarial compliance & audit report and Related Party Transactions (RPT) disclosures.
- The penal implications when an issuer of listed NCS and/or commercial paper fails to comply with the continuous disclosure norms prescribed by SEBI, formats for statements/reports to be submitted to the stock exchange(s) by an entity that has listed its securitised debt instruments and for providing information relating to credit rating obtained and payment of principal/dividend/interest with respect to the NCS issued.
- Requirements to be complied with include formats for reporting that are applicable to entities that have listed their NCDs and/or NCRPS and intend to undertake/are in involved in any scheme of arrangement.

CIRCULAR DATED 09 DECEMBER 2022: FOREIGN INVESTMENT IN ALTERNATIVE INVESTMENT FUNDS (AIFS)

According to SEBI (AIF) Regulations, 2012, AIFs are allowed to raise the funds from any investor whether Indian/foreign/non-resident Indians, by way of the issue of units. In this regard, vide this circular, SEBI clarifies that:

- The manager of an AIF must ensure that the foreign investor of the AIF is a resident of the country whose securities market regulator is a signatory to the International Organisation of Securities Commission's Multilateral Memorandum of Understanding or a signatory to the bilateral Memorandum of Understanding with SEBI subject to an exception that commitment is accepted from an investor being Government or Government related investor or the resident of a country approved by the Government of India.
- The investor or its underlying investors contributing 25% and above in the total corpus is not the person(s) mentioned in the sanctions list notified by United Nations Security Council and is not a resident in the country identified in the public statement of the Financial Action Task Force, as specified.
- In case an investor does not meet the above conditions subsequent to its onboarding, the manager of the AIF shall not draw down any further capital contribution from such investor for making an investment, until the investor again meets the said conditions.

CIRCULAR DATED 09 DECEMBER 2022: CLARIFICATION ON CIRCULAR OF SCHEME(S) OF ARRANGEMENT (SOA) BY ENTITIES HAVING LISTED THEIR NCDS/NCRPS

The circular clarifies that the operational guidelines (issued in November 2022) containing aspects with reference to SOA by entities having listed their NCDs/NCRPS would not apply to the SOA which solely provides for an arrangement between a debt-listed entity and its unlisted wholly owned subsidiary. Such debt-listed entities shall file the draft of SOA with stock exchanges for the purpose of disclosure and which shall further disseminate the scheme documents on their websites.

NOTIFICATION DATED 09 DECEMBER 2022: SEBI (PROCEDURE FOR BOARD MEETINGS) (AMENDMENT) REGULATIONS, 2022 (THE AMENDED REGULATIONS)

The Amended Regulations amends Regulation 4 of the SEBI (Procedure for Board Meetings) Regulations, 2001 (Original Regulations) which provides for the place and time of meetings by adding a proviso to it stating that a member who intends to participate in a meeting through VC or any OAVM, must communicate in advance to the Chairperson or the Secretary of the Board and follow the specified procedure for the same.

Further, a Schedule I providing 'Procedure for allowing Members to participate in Board meetings through VC or OAVM has also been inserted.

CIRCULAR DATED 19TH DECEMBER 2022: CLARIFICATION TO CIRCULAR ON ENHANCED GUIDELINES FOR DEBENTURE TRUSTEES AND LISTED ISSUER COMPANIES ON SECURITY CREATION AND INITIAL DUE DILIGENCE (PREVIOUS CIRCULAR)

SEBI in its Previous Circular recognised that

- a change in the underlying security,
- creation of additional security, or
- creation of additional security in case of unsecured debt securities

will amount to structural changes in the terms of listed debentures under Regulation 59 of the SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015 (SEBI LODR) and accordingly, the depository shall assign a new International Securities Identification Number (ISIN) to the NCDs post submission of documents and shall share information with respect to change in ISIN of debt securities with the recognised Stock Exchanges.

SEBI, vide this circular, now clarifies that, none of the above cases would lead to a change in the structure of the NCDs unless there are changes in the terms/nature of the issue of the NCDs like maturity date, face value, redemption schedule, nature of securities, etc.

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA ("IBBI")

CIRCULAR DATED 12 DECEMBER 2022: INSOLVENCY PROFESSIONALS (IP) TO ACT AS INSOLVENCY RESOLUTION PROFESSIONALS (IRP), LIQUIDATOR, RESOLUTION PROFESSIONALS (RP), AND BANKRUPTCY TRUSTEES (BT) (RECOMMENDATION) (SECOND) GUIDELINES, 2022 (THE GUIDELINES)

The Guidelines shall come into effect from 01 January 2023 and have been issued in supersession of earlier guidelines issued on 08 June 2022.

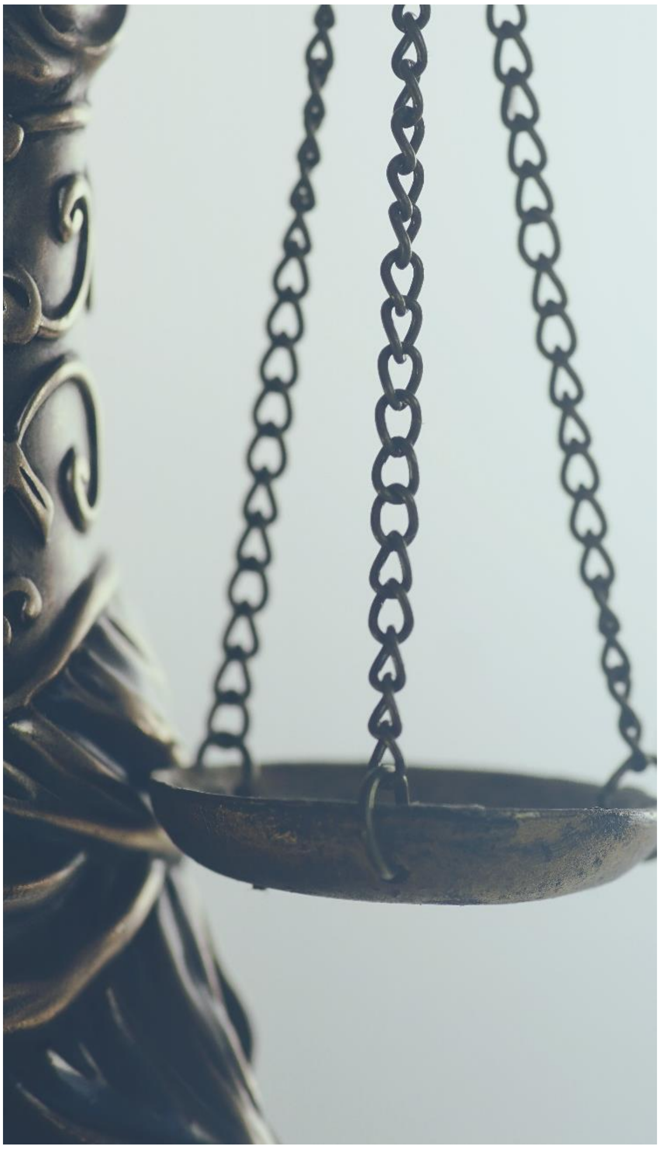
Key highlights of the Guidelines are as under:

- In case of Corporate Insolvency, the IBBI is required, under the Insolvency and Bankruptcy Code, 2016 (IBC) to recommend the name of an IP, basis reference given by the Adjudicating Authority (AA), for appointment as IRP or Liquidator, in the manner as provided in the Guidelines.
- In case of Individual Insolvency, the IBBI is required under the IBC, to recommend the name of an IP for appointment as RP or BT in the manner as provided in the Guidelines.

- At the time of reference/directions received from the AA, the IBBI usually would not have information about the volume, nature and complexity of an insolvency or bankruptcy process and the resources available at the disposal of an IP. Further, it may take around 2-3 weeks for the processing of appointments to get over considering the time required from the AA to reach the IBBI and IBBI to further identify & recommend the name of the IP to the AA, post which only the AA could appoint the recommended IP.
- To avoid any kind of administrative delays, the IBBI is to prepare a common Panel of IPs for the appointment (subject to eligibility as per guidelines) as IRP, Liquidator, RP, and BT and share the same with the AA in accordance with these Guidelines. The Panel will have zone wise list of IPs based on the registered office of the IP and each panel shall have a validity of 6 months.
- The Guidelines also provide for the eligibility conditions to be included in the panel of IPs.
- 'Form A' provides an expression of interest to act as an IRP, Liquidator, RP, and BT, in any process relating to any corporate or individual debtor is also specified.

CIRCULAR DATED 21 DECEMBER 2022: PROFORMA FOR REPORTING LIQUIDATOR'S DECISION(S)

The Circular provides that if the liquidator takes a decision different from the advice given by the Stakeholders' Consultation Committee on certain matters specified, he shall report the reasons for such decision to the AA and the IBBI, in the format/proforma as provided in the circular and also made available at www.ibbi.gov.in.



DIRECT TAX

CIRCULARS / NOTIFICATIONS / PRESS RELEASE

E-FILING OF FORM 10F RELAXED FOR A CERTAIN NON-RESIDENT TAXPAYER

In a previous notification issued in July 2022, the Central Board of Direct Taxes (CBDT) mandated certain forms, including Form 10F, to be filed electronically. With a view to addressing practical challenges faced by non-resident taxpayers, the CBDT has issued another notification giving relaxation to certain non-resident taxpayers from the e-filing of Form 10F. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-e-filing-of-form-10f-relaxed-for-certain-non-resident-taxpayer

[F. No. DGIT(S)-ADG(S)-3/e-Filing Notification/Forms/2022/9227, dated 12 December 2022]

JUDICIAL UPDATES

EXPENSES INCURRED TOWARDS THE PHYSICIAN'S SAMPLE ARE ALLOWED AS A DEDUCTION UNDER SECTION 37 OF THE IT ACT

Taxpayer, an Indian Company, is engaged in the business of manufacturing pharmaceuticals. For the relevant year under consideration, inter-alia, the taxpayer had claimed a deduction of free sample and physician sample. The taxpayer also incurred conference expenses i.e. travel costs to doctors for conferences and gifts to doctors. At the time of assessment proceedings, the tax officer disallowed the aforementioned expenses to the tune of 50% claimed under section 37 of the IT Act. Aggrieved, the taxpayer preferred an appeal before the Dispute Resolution Panel (DRP) which confirmed the action of the tax officer.

Further aggrieved, the taxpayer filed an appeal before the Mumbai Tax Tribunal which allowed the deduction claimed of a free sample as a physician sample and made the following observations:

- With respect to free samples, the same neither gets covered by the decision of the Supreme Court in the case of Apex Laboratory Private Limited nor it is prohibited by Indian Medical Council (Professional Conduct, Etiquette and Ethics) Regulations 2002 (MCI Code).
- Free sample of medicines supplied to doctors is for the promotion of the product of the pharmaceutical company. When a new product is launched, the doctors through the free sample provided, test the marketability of the new drug launched in the market, and give necessary inputs regarding its acceptability, etc. of the product.
- The provision of free samples helps impart knowledge to other doctors about the new medicine/product coming into the relevant practice of their profession. Therefore, the distribution of free samples is directly related to the business promotion activity of the pharmaceutical company and is wholly and exclusively for the purposes of the business of the company.
- Providing free samples of pharmaceutical products is not prohibited either under the Uniform Code of Pharmaceutical Marketing Practices by the Department of Pharmaceuticals, 2014 (UCPMP) or the 2019 Organisation of Pharmaceutical Producers of India (OPPI) Code of Practice.
- The UCPMP prescribes guidelines under which medical samples should be dispensed which ensure that they are used strictly for clinical evaluation purposes and each sample shall be marked “free medical sample- not for sale”.

[1] Apex Laboratory Private Limited v/s. DCIT [135 taxmann.com 286] (Supreme Court)

- The Uniform Code for Medical Device Marketing Practices (UCMDMP) lays down guidelines to ensure that medical devices are distributed as free samples for evaluation purposes only.
- Further, The Drugs and Cosmetics Rules, 1945 also recognises the practice of providing drugs for distribution to medicinal professionals as a free sample by providing specific labelling requirements- "Physician's Sample- Not to be sold".
- Since the taxpayer has submitted complete details of such expenses, disallowing the same to the extent of 50% is not justified when the same issue is covered in favour of the taxpayer by coordinated bench ruling in earlier years.
- Accordingly, the expenses incurred towards free samples to doctors were allowed as business expenditures under section 37 of the IT Act.

- With respect to conference-related expenses, disallowance made by lower tax authorities was upheld by placing reliance on the Supreme Court ruling in the case of Apex Laboratory Private Limited.
  [M/s Merk Limited v/s DCIT, ITA No. 1798/Mum/2016 (Mumbai Tribunal)]

BROUGHT-FORWARD BUSINESS LOSS AND UNABSORBED DEPRECIATION ELIGIBLE FOR SET-OFF AGAINST INVESTMENT CO.'S FOREIGN DIVIDEND INCOME

Taxpayer, an Indian Company, is engaged in the business of providing investment and finance and promotion of new companies in various fields to their customers. For the relevant year under consideration, it received a dividend from its Mauritius-based subsidiary. Against this dividend income, it claimed set off of the current year's business loss and deduction under section 80G of the IT Act. The tax officer contended that such foreign dividend income should be taxed at 15% on a gross basis under section 115BBD[2]of the IT Act without allowing any set-off of losses and deductions. Accordingly, the claim of the taxpayer was denied. Aggrieved, the taxpayer filed an appeal before the First-Appellate Authority which upheld the order passed by the tax officer. Further aggrieved, the taxpayer filed an appeal before the Mumbai Tax Tribunal which held in favour of the taxpayer and made the following observations: Section 115BBD provides for a concessional rate of tax of 15% on dividend income received by an Indian company from a foreign company in which the said Indian company holds 26% or more in nominal value of equity shares.

- Basis perusal of section 115BBD of the IT Act, the starting point of the applicability of the said section is a determination of 'total income'. It is only after a determination of total income, the foreign dividend income included in the aforesaid total income shall be subjected to tax at 15% on a gross basis and other income is subject to tax at a normal rate.

- The taxpayer being in the business of providing investment, finance and promotion of companies, it could be construed as an investment company and accordingly the resultant income in the form of the dividend would partake the character of business receipts. In this regard, reference can be drawn from the Supreme Court ruling in the case of Cocanada Radhaswami Bank Ltd[3], Madras High Court in the case of Amalgamations P. Ltd[4], co-ordinate bench ruling in the cases of Tata Motors Ltd[5], Tata Sons Ltd[6], and finally in taxpayer's own case reported for FY 2003-04.

- Non-obstante clause in section 115BBD(1) of the IT Act covers the current year's loss as well as brought forward losses. Reference can be drawn from a recent co-ordinate bench ruling in the case of Essar Shipping Limited[7].

- With regard to brought forward losses, further reference can be drawn from a recent ruling of the Chennai tax tribunal in the case of M/s Tamil Nadu Industrial Development Corporation Ltd[8] wherein it was held that the investments made by the taxpayer to exercise control over the other investee companies constitutes the business activity of the taxpayer and thus would be entitled to set-off of brought forward business loss and unabsorbed depreciation of earlier years against the dividend income earned from such investment

  [Tata Industries Ltd v/s DCIT, ITA No. 217/Mum/2020 (Mumbai Tribunal)]

EXTENDED TIME-LIMIT FOR REASSESSMENT INAPPLICABLE ON ASSESSMENTS CONCLUDED AND TIME-BARRED PRIOR TO THE DATE OF AN AMENDMENT PROVIDING TIME-LIMIT

The taxpayer, an individual, was subject to reassessment for FY 1998-99 and 2003-04 vide notice under section 148 of the IT Act issued in March 2015. The notice was issued based on certain incriminating documents unearthed from the premises of the taxpayer's father. Based on this evidence, the tax officer was able to establish that the taxpayer was the beneficial owner/beneficiary of a bank account in Geneva and she has not disclosed the same in her return of income filed in India. Further, the taxpayer's parents had investments in Resurgent India Bonds and its maturity was received by the taxpayer. However, she was not able to furnish the source of investment. Based on the

[2] Section 115BBD provides for a concessional rate of tax of 15% on dividend income received by an Indian company from a foreign company in which the said Indian company holds 26% or more in nominal value of equity shares.
[3] CIT v/s. Cocanada Radhaswami Bank Ltd [57 ITR 306] (Supreme Court)
[4] CIT v/s. Amalgamations P. Ltd [108 ITR 895] (Madras High Court)
[5] Tata Motors Ltd v/s. DCIT, ITA No. 3424/Mum/2019 (Mumbai Tribunal)
[6] Tata Sons Ltd, ITA No. 3664/Mum/2017 (Mumbai Tribunal)
[7] DCIT v/s. Essar Shipping Limited, ITA No. 821/Mum/2022 (Mumbai Tribunal)
[8] M/s Tamil Nadu Industrial Development Corporation Ltd v/s. ACIT, ITA No. 1181/Chny/2008 (Chennai Tribunal)

above evidence, the tax officer was of the view that income has escaped assessment and accordingly reopened assessment by taking aid of section 149(1)(c) of the IT Act. Aggrieved, the taxpayer preferred an appeal before the First-Appellate Authority who held in favour of the taxpayer. Aggrieved, tax authorities filed an appeal before the Mumbai Tax Tribunal who concurring with the view of the First-Appellate Authority that once the proceedings for a particular year have attained finality on the expiration of the period of limitation, such concluded proceedings cannot be reopened by resorting to the subsequent amendment in law and made following observations: Section 149(1)(c)[9] provides that reassessment notice can be issued if four years, but not more than sixteen years have elapsed from the end of the relevant assessment year in case the income pertaining to any foreign asset which is chargeable to tax, has escaped assessment.

- For FY 1998-99 and 2003-04, the timelines provided for reopening assessments were seven years as per Finance Act 1999 and six years as per Finance Act 2004. Finance Act, of 2012 extended the time limit to sixteen years in cases where the income that has escaped assessment pertains to an asset outside India. Further, the amended section 149 clarified that the provisions shall also be applicable for any assessment year beginning on or before 01 April 2012. However, the time limit for initiating reassessment proceedings for FY 1998-99 and 2003-04 had expired before this amendment.
- Reliance can be placed on the Delhi High Court ruling in the case of Brahm Datt[10] and Calcutta High Court in the case of Jayashree Jayakar Mohankar[11] wherein it was held that the amendment in section 149(1)(c) by Finance Act 2012 extending the limitation period to sixteen years could not be resorted for reopening assessment where time had already expired before the amendment became effective. Further, the tax authorities' Special Leave Petition against the Delhi High Court ruling was dismissed by the Supreme Court.

  [DCIT v/s. Smt. Deval D. Thakkar, ITA No. 968/Mum/2020 & ITA No. 974/Mum/2020 (Mumbai Tribunal)]

SUPREME COURT HOLDS REASSESSMENT PROCEEDING INVALID WHEN THE RECTIFICATION PROCEEDING IS ONGOING

Section 154 of the Income-tax Act, 1961 states that any mistake apparent from the record can be rectified within 4 years from the end of the year in which the concerned order is received. The tax officer, either suo-moto or on an application made by the taxpayer, carries out the rectification of the mistake. Further, the Tax Officer has the power to reopen a proceeding if the income has escaped assessment subject to certain conditions/restrictions. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-sc-holds-reassessment-proceeding-invalid-when-the-rectification-proceeding-is-ong

[M/s S.M. Overseas Pvt. Ltd. vs. CIT, Civil Appeal No. 3612-3613/2012, Supreme Court]

[9] Section 149(1)(c) provides that reassessment notice can be issued if four years, but not more than sixteen years have elapsed from the end of the relevant assessment year in case the income pertaining to any foreign asset which is chargeable to tax, has escaped assessment.
[10] BrahmDatt v/s. ACIT & Others, WP (C) 1109/2016 (Delhi High Court)
[11] DCIT v/s. Jayashree Jayakar Mohankar, ITA No. 37 & 38/Kol/2018 (Calcutta High Court)

INDIRECT TAX

GOODS & SERVICES TAX (GST)

JUDICIAL UPDATES

WRIT PETITION

THE AAR HAS TO HEAR THE THIRD PARTIES WHERE THE AGGRIEVED PARTY OF THE RULING IS OTHER THAN THE APPLICANT

Facts of the case

- M/s. Gayatri Projects Ltd. (Taxpayer) filed a Writ petition against the order passed by the West Bengal AAR in respect of an Advance Ruling Application filed by the applicant (M/s. Eastern Coalfields Limited) wherein it was held that the applicant is not entitled to claim for input tax credit (ITC) on invoices issued by the Taxpayer during the period January, February, March 2020 since the Taxpayer had furnished Form GSTR-1 and Form GSTR-3B in November 2020 (i.e. after the due date provided under Section 16 of the CGST Act) and, therefore, holding that the applicant would be required to reverse the ITC claimed on the procurements made from the Taxpayer.

Contention of the Taxpayer

- Though the ITC claimed by the application pertains to the invoices issued by the Taxpayer, the Taxpayer was not heard by the AAR since they were not made parties to the Advance Ruling Application.
- The Taxpayer filed the Writ petition contending that due to the Impugned Ruling, the applicant had taken a position to not make payment of the GST component charged by the Taxpayer. It is undisputed that the Taxpayer had duly discharged applicable GST to the Government and consequently, non-payment of such component would violate of Article 19(1)(g) and 300A of the Constitution of India and would also stand contrary to the provisions of the CGST Act.
- It was contended that the AAR's decision has been made with the finding of fact that excess ITC had been availed by the applicant without determining the ITC eligibility (including provisional credit, if any) based on procurements reflected in Form GSTR-2A.
- It was further contended that the applicant did not place the correct facts before the AAR as regards the ITC eligibility (including provisional credit entitlements, if any), and hence, the observation as regards excess availment of ITC has been made without appreciating the facts of the present case.
- The Taxpayer was unaware of the Advance Ruling Application filed by the applicant which was observed only once the order was passed by the AAR.
- Though the Taxpayer had made a request to the applicant to prefer an appeal to the AAAR, such a request was not considered and all these factors necessitated the Taxpayer to approach the Honorable High Court.

Observations and ruling by the Honorable High Court

- The invoices, which were the subject matter of consideration by the AAR were issued by the Taxpayer. Therefore, the Taxpayer should have been put on notice by the AAR, or the applicant ought to have impleaded the Taxpayer in the proceedings before the AAR.

- It is undisputed that the Taxpayers are aggrieved against the Impugned Ruling. The applicant has not preferred an appeal, such conduct cannot prejudice the rights of the Taxpayer.
- The Honorable High Court observed that the Taxpayer cannot be non-suited by virtue of an order, which was passed by the AAR without hearing them, since the Taxpayer has contended that sufficient factual details were not placed before the AAR.
- It was observed that directing the Taxpayer to prefer an appeal to the AAAR may not be effective since the facts, which the Taxpayer seeks to bring on record were not placed before the AAR;
- The matter has to be re-examined by the AAR instead of directing the Taxpayer to approach the AAAR;
- The Taxpayer should not be left remediless and the matter must be remanded to the AAR for fresh consideration;
- In view of the above, the Honorable High Court directed the AAR to issue notice to the Taxpayer and the applicant, hear the parties afresh, permit the Taxpayer to submit documents as well as written submissions and thereafter fresh orders are to be passed on merits and in accordance with the law.

  [Calcutta High Court, M/s. Gayatri Projects Ltd and Anr. Vs. Assistant Commissioner of State Tax dated 05 January 2023]

ORDERS BY AUTHORITY FOR ADVANCE RULING (AAR)

TRANSFER OF AN INDEPENDENT PART OF BUSINESS QUALIFIES TO BE A TRANSFER OF GOING CONCERN AND EXEMPT FROM GST

Facts of the case

- M/s. Capfront Technologies Pvt Ltd.(Taxpayer) is a start-up based in Bengaluru, incorporated in 2018, with the focus on providing data analytics, digital marketing services & product development;
- The Taxpayer owns a mobile application, developed and owned by them, called as ‘LoanFront’, which is a fintech product and is used as a digital platform to facilitate the lending of short-term personal loans.
- The Taxpayer intended to transfer the said mobile application software to their wholly-owned subsidiary M/s. Vaibhav Vyapaar Private Limited (VVPL).

Question before the AAR

- Whether the GST would be leviable on the aforesaid transfer of mobile application software

Contention by the Taxpayer

- The Taxpayer is a ‘going concern’ as per the Accounting Standards as the same is expected to be in operation for the foreseeable future. The Taxpayer neither has the intention nor the necessity of liquidation or of curtailing materially the scale of operations.
- It was also contended that a business is said to be transferred as a going concern, if
  - The assets must be sold as a part of ‘business' as a going concern
  - The purchaser intends to use the assets to carry on the same kind of business as the seller
  - Where only part of the business is sold, it must be capable of separate operations
  - They must not be a series of immediately consecutive transfer
- Basis the above, the transfer of the mobile application falls under the ambit of transfer mentioned at entry no:2 in notification no:12/2017-CT(R) dated 28 June 2017 (Exemption notification).

Observations and ruling by the AAR

- The AAR noted that the statement of facts conveys that the transfer of business pertains to the ‘LoanFront’ app sought to be sold is a fully functional part of the business and the transaction contemplates the transfer of the entire business to VVPL who would not only enjoy a right over the assets but shall also take over the liabilities.
- It postulates that there will be a continuity of business, as the said part of the business would be functional and is decided to be transferred as a whole to the new owner. It amounts to the transfer of a going concern, of the said independent part of the business.
- The transfer of an independent part of business pertaining to ‘LoanFront’ app, a mobile software, qualifies to be a transfer of going concern, and the said activity amounts to ‘Service by way of transfer of going concern as an independent part’, and thus, is exempted from GST in terms of entry no:2 of the exemption notification.

  [AAR-Karnataka, M/s. Capfront Technologies Pvt Ltd, Ruling no: KAR ADRG 47/2022 dated 28 November 2022]

TRANSFER OF DEVELOPMENT RIGHTS BY LANDOWNER AMOUNTS TO CONSIDERATION

Facts of the case

- M/s. Maddi Seetha Devi (Taxpayer) is a landowner and has entered into a joint development agreement with a builder

- The Taxpayer has supplied development rights to the builder in exchange for construction services. In this regard, Taxpayer intends to know the liability of transfer of development rights and time of supply under the Goods and Services Act, 2017.

Questions before the Authority

- Whether development rights received by the builder can be construed as consideration received by such builder
- Whether liability to pay GST arises on the developer on receipt of development rights or upon handover of constructed place

Submissions made by Taxpayer

- The Taxpayer submitted that they have entered into a joint development agreement on an area-sharing basis prior to the introduction of GST. In this regard and in view of recent amendments in GST, Taxpayer intends to know the applicability of GST on such transactions.

Observation and ruling by the AAR

- The AAR, after examining notification no:03/2019 dated 29 March 2019 and notification no:04/2019 dated 25 January 2018, concluded that the transfer of development rights by the landowner shall be considered as consideration received by such developer and tax on a portion of the constructed area shall be paid by him. Further, the Taxpayer shall claim credit of such tax paid at the time of further sale of a property.
- AAR also ruled that liability to pay GST shall arise at the time of transfer of possession of constructed place to the Taxpayer i.e. landowner.

[AAR-Telangana, M/s. Maddi Seetha Devi, Rulingn no:47/2022, dated 13 July 2022]

TRANSFER PRICING

RULINGS

VALUE OF ASSETS RETAINED BY THE TAXPAYER DURING A BUSINESS TRANSFER TO BE EXCLUDED WHILE DETERMINING ARM'S LENGTH PRICE

The taxpayer transferred its IT support and back-office support services Business Unit to its Associated Enterprise (AE) under a business transfer agreement which inter alia provided that the parties can agree to adjust the consideration on the basis of the identity and value of the assets and liabilities actually transferred.

The Valuation of the transaction was done by an independent valuer applying Discounted Cash Flow (DCF) method.

The taxpayer retained certain assets, namely cash and cash equivalent, net tax receivables, tangible assets, security deposit, receivables from customers, service tax receivable (refund) as well as certain liabilities namely, tax withheld, accrued pension contribution and payables to creditors. The net value of the same was reduced from the consideration agreed between the parties for the transfer of the business unit and accordingly reported as an international transaction.

The Transfer Pricing Officer (TPO) and the Dispute Resolution Panel (DRP) did not appreciate the fact that certain assets and liabilities were retained by the taxpayer and there ought to have been an adjustment for the same vis-à-vis the consideration agreed between the parties.

The Honorable Delhi Tribunal held that there is no reason to not consider the addendum, exhibits to the business transfer agreement and evidence on record and that the totality of facts and circumstances should be taken into consideration and the value of only those assets and liabilities which have been transferred should be considered for determining the Arm's Length Price (ALP).

DC/ACIT Vs. Saxo India Pvt Ltd [TS-837-ITAT-2022(DEL)-TP]

ARITHMETIC MEAN AND NOT WEIGHTED AVERAGE TO BE APPLIED FOR DETERMINING ARM'S LENGTH PRICE

The taxpayer is engaged in providing financial services in the nature of stock broking, institutional equity sales and trading services to domestic as well as overseas institutional clients (including its Associated Enterprises (AE)).

During the year under consideration, the provision of broking services and derivative income and support services was benchmarked using Transactional Net Margin Method (TNMM) as the Most Appropriate Method (MAM). Further, the investment banking services were benchmarked using Profit Split Method (PSM) and also TNMM as the MAM.

In line with the Taxpayer's litigation history, TNMM was rejected as the MAM and Comparable Uncontrolled Price (CUP) Method was adopted as the MAM by the TPO.

The TPO made an adjustment by computing the arithmetic mean of the brokerage charged (based on the number of trades executed) and granted an adjustment of 29.50% on account of marketing cost. But the research cost and volume adjustment were not granted by the TPO. The taxpayer filed an application before the Dispute Resolution

Panel against the adjustment made by the TPO.

The DRP upheld CUP as the MAM and allowed the adjustment granted on account of marketing. Further, the DRP stated that the consideration of 'weighted average rates' instead of only 'arithmetic mean' would take care of any adjustments related to volume and research cost.

The Honorable Tax Tribunal followed the decisions of the co-ordinate benches in the taxpayer's own case for the previous years and granted a deduction of 40% towards research cost and volume adjustment against the 29.50% granted by the TPO.

In a departure from the previous decision given for the taxpayer, by a plain and literal interpretation of the law, the Honorable Mumbai Tribunal held that only arithmetic mean should be taken and not the weighted average of such prices for determining ALP.

Morgan Stanley India Company Private Limited Vs. Asst. CIT (TS-866-ITAT-2022(Mum)-TP)

REJECTION OF FOREIGN AE AS A TESTED PARTY AND IMPUTING MARK-UP ON THE TRANSACTION OF REIMBURSEMENT

The taxpayer imported raw materials and components from its AEs, which was benchmarked using Transactional Net Margin Method (TNMM) as the most appropriate method (MAM). Further, the foreign AEs were determined to be the least complex entities based on the FAR analysis (functions performed, assets analysed and risks assumed). The taxpayer undertook a detailed benchmarking analysis and selected companies based in the European region as comparables since almost 90% of its imports were from AEs in the European region.

The Transfer Pricing Officer (TPO) rejected the benchmarking analysis conducted by the taxpayer by stating that relevant and reliable documentary information pertaining to the tested parties as well as the comparables was not furnished by the taxpayer to substantiate the selection of foreign AEs as the tested party.

The Honorable ITAT placed reliance on the OECD guidelines, UN TP Manual and judicial precedents, while stating that a tested party should have the following attributes:

- Availability of reliable and accurate data for comparison for itself as well as comparables
- Least complex (amongst the parties to the transaction) and
- Data available can be used with minimal adjustments.

Accordingly, the tested party could be the local entity or foreign AE, subject to the satisfaction of the aforesaid criteria.

The Honorable Tribunal observed that the taxpayer failed to furnish the financial statements of the foreign AE nor was the group transfer pricing policy furnished, even at the time of the hearing. Accordingly, the ITAT rejected the foreign AEs as the tested party and considered the taxpayer as the tested party.

REIMBURSEMENT OF EXPENSES:

The taxpayer incurred certain expenditures towards travel, lodging, employee cost, communication, etc. on behalf of its AEs, which was recovered on a cost-to-cost basis. The TPO re-characterised the reimbursements as the provision of support services and imputed a markup of 5% on the same. The DRP disregarded the submissions of the taxpayer and upheld the adjustment made by the TPO.

The Honorable ITAT observed that the TPO was unable to demonstrate the value addition to the cost incurred by the taxpayer. However, an unrelated party will not incur any cost without having any benefit from the party and therefore the taxpayer should have charged some amount of fees on account of additional costs in the nature of administrative cost, employee cost, etc. while performing such activities on behalf of the AEs. As such the onus was on the taxpayer to benchmark the transaction but had failed to do so. Accordingly, the TPO's approach of imputing a 5% markup on the cost of reimbursement was upheld.

Schneider Electric Infrastructure Limited Vs. DCIT Vadodara (TS-856-ITAT-2022Ahd-TP)

UPDATES

TP DEVELOPMENTS: UAE

The UAE ministry of finance on 09 December 2022 released the Federal Decree-Law No.47 of 2022 (Decree) along with Frequently asked questions (FAQs) on the taxation of corporations and businesses (including the Transfer Pricing provisions). The provisions contained in the law will take effect for financial years starting on or after 01 June 2023. A summary of the Transfer Pricing provisions has been tabulated below:

Arm's Length Principle and Applicability

Transfer pricing rules seek to ensure that transactions between Related Parties are carried out on arm's length terms as if the transaction was carried out between independent parties. Further, various Articles in the Decree require that the consideration of transactions with Related Parties and Connected Persons need to be determined by reference to their 'Market Value'.

Transfer pricing rules apply to UAE businesses that have transactions with Related Parties and Connected Persons, irrespective of whether the Related Parties or Connected Persons are located in the UAE mainland, a Free Zone or in a foreign jurisdiction

Related Parties and Control

Related parties include both natural as well as juridical persons.

In this connection, Related Parties of a Company refer to any other companies in which the Company, alone or together with their Related Parties, has a controlling ownership interest (typically 50% or more of shares of the company), or that are under greater than 50% common ownership.

Connected persons

- An owner of the business
- A director or officer of the business or
- A Related Party of any of the above

Transfer pricing methods

Any one or a combination of the following methods can be used to determine the arm's length price:

- Comparable uncontrolled price method
- Resale price method
- Cost plus method
- Transactional net margin method
- Transactional profit split method

A taxpayer can adopt any other method if it is able to demonstrate that none of the aforesaid methods are appropriate to determine the ALP of the transaction and that the other method adopted would lead to an arm's length result.

Adjustment

An adjustment can be made by the Federal Tax Authority (Authority) to the taxable income of the taxpayer, where the result of the transaction/arrangement does not fall within the arm's length range.

Corresponding adjustment

In case of an adjustment by any foreign competent authority which impacts the UAE entity, an application requesting for the corresponding adjustment would be required to be filed by the taxpayer with the Authority for obtaining relief. However, a similar application is not required in the case of domestic transactions.

Documentation

- Certain businesses will be required to file details regarding transactions with Related parties and Connected persons along with the Tax return
- Certain businesses may be required to maintain a Master File as well as a Local file
- Any other information to support the arm's length nature of the taxable person's transactions/arrangements with its Related parties and Connected persons

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