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ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA ("ICAI")

EAC Opinion – Accounting treatment of Compulsorily Convertible Debentures (CCDs) by the issuer under Ind AS 32, Financial Instruments: Presentation

Facts of the case

A Company is jointly promoted by an oil and gas extraction company and an oil marketing company (OMC) with current shareholding in the ratio of 49% and 51% (with 0.0002% held by individuals).

During March 2020, the Company issued CCDs to investors (NBFCs and bank) to the extent of Rs.1,000 Crore with backstop support from the promoter companies. The Company has an obligation to service the interest pay-outs during the tenure of the CCDs. It is also Sponsors' obligation to ensure that the Company meets the interest obligations on time.

The CCDs are not convertible in the hands of investors under any circumstance and the put option can be exercised by investors only on the sponsors and not on the issuer (the Company). These CCDs are convertible only in the hands of sponsors at the end of the tenure/buy-out option or exercising of put option by the investors (mandatory and irrevocable put option available to investors on sponsors only) and the Company would be required to convert the same into equity shares of the Company ranking pari-passu with existing shares at the time of conversion in the same proportion of shareholding /backstop support by reckoning share price at that time as per conversion formula defined in the transaction documents. Objective of such CCD issuance was to de-leverage the highly leveraged balance sheet of the Company through deferred equity infusion considering eventual merger plans of the oil and natural gas extraction company with OMC in the near term. The Company's CCD issuance was carried out broadly in line with CCDs transaction structure of a group company.

The company has given the accounting policy followed:

"3.20.1.2 Compound financial instruments

The component parts of compound financial instruments issued by the Company are classified separately as financial liabilities and equity in accordance with the substance of the contractual arrangements. At the date of issue, the fair value of the liability component is estimated using the prevailing market interest rate for similar instruments. This amount is recognised as a liability on an amortised cost basis using the effective interest method until extinguished upon conversion or at the instrument's maturity date. The conversion option classified as equity is determined by reducing the amount of the liability component from the fair value of the compound financial instrument as a whole. This is recognised and included in equity, net of income tax effects, and is not subsequently remeasured. In addition, the conversion option classified as equity will remain in equity until the conversion option is exercised, in which case, the balance recognised in equity will be transferred to other component of equity. When the conversion option remains unexercised at the maturity date of the convertible note, the balance recognised in equity will be transferred to retained earnings. No gain or loss is recognised in profit or loss upon conversion or expiration of the conversion option. Transaction costs that relate to the issue of the convertible notes are allocated to the liability and equity components in proportion to the allocation of the gross proceeds. Transaction costs relating to the equity component are recognised directly in equity. Transaction costs relating to the liability component are included in the carrying amount of the liability component and are amortised over the lives of the convertible notes using the effective interest method."

Accounting Methodology: In view of the nature of instrument being compound financial instrument, accounting for the same has been carried out in the books of the Company by bifurcating the total proceeds of CCDs into equity and liability/debt components in compliance with Indian Accounting Standard (Ind AS) 32, 'Financial Instruments: Presentation'. The liability component of the same has been determined by considering discounted value of future cash outflows of the Company on account of the interest service obligations. The liability/debt component derived has been reduced from total value of CCDs to arrive at equity component accounted under other equity in financial statements.

The company has given the rationale and justification for accounting methodology followed by the Company as follows:

- Company's views on accounting methodology:
  The Company has completed issuance of CCDs during March, 2020 to three investors after execution of all relevant documents and receipt of subscription. Post allotment of debentures to investors, the CCDs are held by investors in the capacity of debenture holders duly represented by debenture trustees. The said CCDs are backstop supported by the Sponsor/Promoter Companies, viz., oil marketing company and oil and gas extraction company in the ratio of 51% and 49% through option agreement. From the transaction documents, it may be noted that the following features are unique to this arrangement:
  - Investors have un-conditional irrevocable put option on sponsors only and not on the issuers (the Company). The CCDs are compulsorily convertible into equity capital of the Company in the hands of the Sponsors in accordance with the terms of transaction documents. Issuer would be issuing shares to sponsors and not to the investors. Conversion price of shares would be determined based on valuation at the time of such conversion.

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Post issuance, shares would be ranking pari-passu with existing shares.

- Company's liability is limited to payment of interest to the investors as the value of CCDs is paid back to the investors by the Sponsor Companies upon exercising of Put Option. Pursuant to the option agreement, Sponsor/Promoter companies have undertaken that they will ensure that the service account is operated, maintained and funded at all times, in accordance with the terms of the transaction documents.
- Sponsors have extended the backstop support as above in the ratio of their existing shareholding.

Considering the above unique features of the CCDs read with the terms of transaction documents, the legal point of view on nature of the instrument is that, the consequence of infusion of funds by Parents/ Sponsors through CCDs will ultimately be an equity investment into the Company pursuant to conversion of CCDs to equity shares of the Company; and such conversion is not optional but compulsory and does not contemplate repayment of the principal by the issuing Company. Hence, the CCDs issued by the Company can be characterised as equity related instruments or quasi-equity instruments from the date of issuance of such CCDs by the Company.

Further, the Central Government while bringing about the changes in Foreign Policy structure under Foreign Exchange Management Act (FEMA) notified FEMA (Non-debt Instruments) Rules, 2019 on 17.10.2019. The said rules while prescribing the conditions on foreign Investment and related matter defines and considers the equity instruments as under:

"Rule 2(k) "equity instruments" means equity shares, convertible debentures, preference shares and share warrants issued by an Indian company;

Explanation: -

- Equity shares issued in accordance with the provisions of the Companies Act, 2013 shall include equity shares that have been partly paid. "Convertible debentures" means fully, compulsorily and mandatorily convertible debentures…
- Rule 2 (ai) "non-debt instruments" means the following instruments; namely:- (i) all investments in equity instruments in incorporated entities: public, private, listed and unlisted; …"

The sum and substance of above discussions clearly classify the CCDs as equity related instrument or quasi-equity instrument or non-debt instrument.

▪ Accounting Treatment: With the above background, the accounting treatment of such instrument in the Company's financial statements is considered as under:

The financial statements are prepared in accordance with the Companies Act and Ind AS; and the Company has to comply with the requirements of Division II – Ind AS Schedule III to the Companies Act, 2013. The Institute of Chartered Accountants of India (ICAI), to comply with these provisions, issued Guidance Note (GN) on Division II- Ind AS Schedule III to the Companies Act, 2013 (GN revised edition issued during July-2019).

- Analysis of relevant paragraphs of Guidance Note and Indian Accounting Standards (Ind AS):

Guidance Note

"Paragraph 8.2.1.6. states that, Ind AS 32 defines an equity instrument as "any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities". The accounting definition of 'Equity' is principle based as compared to the legal definition of 'Equity' or 'Share', such that any contract that evidences residual interest in an entity's net asset is termed as 'Equity' irrespective of whether it is legally recognized as a 'Share' or not. Accordingly, all instruments (including convertible preference shares and convertible debentures) that meet the definition of 'Equity' as per Ind AS 32 in its entirety and when they do not have any component of liability, should be considered as having the nature of 'Equity' for the purpose of Ind AS Schedule III. Such instruments shall be termed as 'Instruments entirely equity in nature'.

Paragraph 8.2.1.7. states that, 'Instruments entirely equity in nature, may be presented as a separate line item on the face of the Balance Sheet under 'Equity' after 'Equity Share Capital' but before 'Other Equity', as shown below:

EQUITY AND LIABILITIES

Equity

- Equity Share Capital
- Instruments entirely equity in nature
- Other Equity

In the Statement of Changes in Equity, the reconciliation for instruments entirely equity in nature should be presented as below:

STATEMENT OF CHANGES IN EQUITY …

- Instruments entirely equity in nature *
  - Compulsorily Convertible Preference Shares

Balance at the beginning of the reporting period	Changes in compulsorily convertible preference shares during the period	Balance at the end of the reporting period

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- Compulsorily Convertible Debentures

Balance at the beginning of the reporting period	Changes in compulsorily convertible debentures during the period	Balance at the end of the reporting period

- [Instrument] (Any other instrument entirely equity in nature)

Balance at the beginning of the reporting period	Changes in compulsorily convertible debentures during the period	Balance at the end of the reporting period

Other Equity [Table providing reconciliation of Other Equity]

* …It is assumed that Instruments entirely equity in nature have such terms and conditions that qualify them for being entirely equity in nature based on the criteria given in para 16 of Ind AS 32. Companies should assess terms and conditions specific to their instruments for deciding whether they are entirely equity in nature.

Paragraph 8.2.1.9 states that, All those compound financial instruments which have both 'Equity' and 'Liability' components, shall be split in accordance with Ind AS 32 and their 'Equity component' shall be presented under 'Other Equity' portion of Statement of Changes in Equity while their 'Liability component' shall be presented as a separate line item under 'Borrowings'.

On going through the above paragraphs of Guidance Note along with related Ind AS provisions and considering the terms and conditions associated with CCDs issued by the Company, it is viewed that:

- In substance, the CCDs are more of equity in nature as these instruments are compulsorily convertible into equity shares of the Company which evidences residual interest in the assets of the Company.
- One more special feature of the contract is, upon conversion, the shares are issued to Sponsors being existing shareholders at their shareholding ratio without altering their control and thereby preserving their stake in residual interest. Even though CCDs are issued by the Company to investors, the redemption happens only through sponsors.
- The only liability to the issuer is serving of coupon rate till the conversion of CCDs into equity shares of the company.

Considering above, the Company's CCDs are in substance equity in nature with co-existence of a component of liability to the Company being serving of coupon rate till buyback by sponsors. Hence, it needs to be evaluated whether the CCDs in entirety qualify as equity in terms of paragraph 16 of Ind AS 32.

It may be noted that, as per paragraph 16 of Ind AS 32 which provides for classifying the instrument as an equity instrument rather than a financial liability in entirety, subject CCDs of the Company are instruments which are more of equity in nature with co-existence of liability component of serving coupon rate. In view of this, requirement of treating the subject CCDs in entirety either as equity or liability as prescribed in paragraph 16 of Ind AS 32 would not arise. Hence, the accounting treatment suggested in paragraph 8.2.1.9 of GN to split the CCDs in accordance with Ind AS 32 into 'equity component' and 'liability component' applicable to a compound financial instrument has been followed.

Ind AS 32 provides for the accounting treatment of compound financial instruments having equity as well as debt component. The standard has specifically dealt with the accounting treatment for such instrument in paragraphs 28 to 32 along with accounting guidance in paragraphs AG30 to AG35 which is an integral part of the standard

As per paragraph 28, the issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.

Paragraph 15 of Ind AS 32 states that the issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.

As per paragraph 31 of Ind AS 32, the issuer of a compound financial instrument will have to split the financial instrument into liability and equity portions by first calculating the liability portion and the residual will be the equity portion.

As per the terms of issue, the obligations on the part of the Company are:

- To service the coupon (interest) to the investors during the period till conversion of CCDs into equity shares.
- Issuance of equity shares ranking at par with existing shares of the Company to the Sponsor companies upon conversion of CCDs.

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- Under no circumstances, the CCDs are convertible in the hands of investors as they are convertible only in the hands of Sponsor.

The interest liability will have to be computed by calculating the present value of the interest scheduled over the tenure of the CCD's.

Paragraph 31 of Ind AS 32 also states that the sum of the carrying amounts assigned to the liability and equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole.

Paragraph AG31 of Ind AS 32 states as follows:

"AG31 A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 28 requires the issuer of such a financial instrument to present the liability component and the equity component separately in the balance sheet, as follows:

- The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option. …"

In the case of the CCD issued by the Company, the obligation is only to pay the contractual cash flows for the interest portion. There are no cash flows contracted for the principal portion due to the put option given to the investors as well as the back stop facility provided by the sponsors. Considering this arrangement, the Company has calculated the present value of their cash flows for interest as a liability and the residual amount as the equity component.

- Further, Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors' prescribes that, developing and applying an accounting policy should result in information that is:
  - relevant to the economic decision-making needs of users; and
  - reliable, in that the financial statements:
  - represent faithfully the financial position, financial performance and cash flows of the entity;
  - reflect the economic substance of transactions, other events and conditions, and not merely the legal form
  - are neutral, ie free from bias;
  - are prudent; and
  - are complete in all material respects
- Keeping the above aspects and considering the special nature of CCDs issued by the Company, accounting policy of the Company, accounting treatment and disclosures are in line with Ind AS requirements including Ind AS 32.

  In view of the above, the Company is of the firm belief that the accounting treatment followed in its financial statements is in compliance with the provisions of Indian Accounting Standards (Ind AS). (Emphasis supplied by the company.)

  The Company also placed reliance on the following which substantiate this CCD transaction instruments to be in the nature of equity:
  - Financial advisor's to the transaction view is as follows:
    - CCD is an alternative to direct equity investment.
    - CCD is accepted as quasi-equity by both rating agencies and the lenders
    - There is no obligation of repayment of the principal amount by the issuer.
  - Legal cases upholding the nature of compulsorily convertible debentures as "Equity in nature" referred by the Company are as under:
    - Supreme Court of India in Narendra Kumar Maheshwari vs. Union of India
    - Ahmedabad Special Bench of ITAT in Ashima Syntex Limited vs. ITAI
    - Ahmedabad Special Bench of ITAT in Banco Products (India) Ltd. vs. DCIT
  - In essence, in the above cases, it has been viewed that a compulsorily convertible debenture, which will automatically convert into equity shares of the issuing company, which does not contemplate repayment of principal by issuing company is regarded as equity instrument from the date of issuance by the issuing company.

    The Company also searched public domain and accessed few relevant examples pertaining to accounting treatment of CCDs followed by other companies. The CCD transaction structures are unique in every case. The Company's CCD transaction structure also being unique cannot be straight away compared with general examples available in publications on accounting and academic discussions.

    The financial statements have been reviewed by resident audit team from the Comptroller and Auditor General (C&AG). C&AG had issued an audit enquiry with regard to accounting methodology followed by the Company w.r.t. CCDs. The audit enquiry was dropped. However, the matter of treatment of CCDs was also taken up by the regional office of C&AG at Chennai by the Audit Team. It was informed that there could be different interpretations under Ind AS with

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regard to CCDs. Considering complexity of the matter and time constraints, the Company extended an assurance of referring the matter to the Expert Advisory Committee of the Institute of Chartered Accountants of India (ICAI). Based on such assurance, C&AG has issued Nil comments for the year and issued a management letter separately advising the Company's management to place the same before Audit Committee & the Board and also take up with the Expert Advisory Committee of the ICAI.

Extract from Management letter issued by the C&AG states as follows:

"Certain Deficiencies noticed as detailed below, were not issued as Audit Comment. However, the same is bought to your notice for Corrective and remedial Action.

Balance Sheet: Equity and Liabilities:

(1) Equity: (b) Other Equity-`(-)19,596.89 million:

The above head 'other equity' includes ` 7,740.67 million arrived at on initial recognition (05.03.2020) after deducting the amortized amount of interest liability of `2,250.89 million and the pro-rata transaction cost of issue of CCD ` 8.44 million from the fair value of CCD ` 10,000 million.

The recognition of equity is not in line with Ind AS 32 [paragraph 16 (a) and 16 (b) (i) read with paragraph 15] and we differ on the accounting treatment followed by the company.

The financial liability on conversion of CCD into equity shares amounting to `10,000 million at the end of tenure is not recognised in the financial statements. The draft provisional comment is dropped on the basis of assurance given by the company to refer the issue to the Expert Advisory Committee (EAC) of the ICAI for its opinion on the treatment of financial liability in the financial statements. Further action taken/proposed to be taken to rectify the lapses/ errors may be communicated to audit."

In view of the management letter of C&AG, the Company seeks EAC opinion on the correctness of the accounting methodology adopted.

The company has supplied the key terms of CCDs as follows:

- **Sponsor:** The two promoter shareholders of the Company
- **Company/Issuer:** The Company
- **Sponsor:** Oil and gas extraction company and OMC
- **Type of Instrument:** Compulsorily Convertible Debentures (CCD)
- **Nature of the Instrument:** The Debenture shall mean an instrument which is compulsorily convertible into equity capital of the Company by the Sponsor/nominees of the Sponsors in accordance with the terms mentioned herein.
- **Mode of Issue:** Private Placement on a fully paid up basis
- **Listing:** Unlisted
- **Issuance Mode:** Demat only. Demat credit to be received within 15 days of the Debentures Pay in-Date.
- **Depository:** NSDL or CDSL
- **Debenture Trustee:** S Trustee Company Limited
- **Use of Funds:** The Company shall use the proceeds for repayment of existing credit facility(ies), availed by the Company and general working capital purposes.
- **Face Value:** Rs 1 Crore per Debenture.
- **No. of Units:** 1,000
- **Tenure:** 36 (thirty-six) months from the Deemed Date of Allotment; with mandatory Put / Call Option at the end of the 35th month.
- **Coupon Payment Date:** shall mean with respect to the first coupon period 31 March, 2020 thereafter on 30th June, 30th September, 31st December and 31st March of each year.
- **Rating of Instrument:** The Debentures are expected to be assigned a rating of AAA (CE).
- **Accelerated Buy Out Option with the Sponsor**
  - Upon signing of a binding term sheet for equity infusion in the Issuer at any time prior to the expiry of 35 months from the Deemed Date of Allotment, the Sponsor may, with a prior written notice of 15 days to the Debenture Trustee, buy-out Debentures at Face Value ("Accelerated Buy Out of Securities") from the Investor (s);
  - Coupon amount accrued and due but unpaid till the date of the Accelerated Buy Out shall be paid to the Investor (s) as on the date of the Accelerated Buy Out.
  - The Sponsors will have a right to buy-out the CCDs (partly or fully at Face Value) at any point of time. On exercising such accelerated buy-out option prior to the 12th month of the instrument, the Investors will be compensated through Yield Protection Premium for the balance period until the end of 12 months from the Pay-in date.
  - The Yield Protection Premium will be calculated as follows for each Debenture – [(Face Value of a Debenture) X (Coupon rate – 1 yr. G-sec rate) X (No. of days till end of 12 months /365)] / [(1+ 1 yr. G-sec rate) ^ (No. of days till end of 12 months /365)]

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“Put Option” or “Mandatory Buy-out by the Sponsor”

- In the event that the Sponsor has not procured a Nominee who has, or the Sponsor by itself has not, acquired all the Debentures from the Investor (s) prior to the expiry of 35 months from the Deemed Date of Allotment of Debentures, the Sponsor will mandatorily, and without requiring any notice or intimation in this regard, buy the outstanding Debentures for the aggregate Face Value of the Debentures and the accrued/ outstanding but unpaid amounts (including but not limited to unpaid coupon amount), if any, at the end of 35th month from the Deemed Date of Allotment (“Mandatory Buy-out”). Purchase of Debentures shall be undertaken mandatorily by the Sponsor for the entire outstanding Debentures amount;
- The Mandatory Buy-out set out above, shall be binding on the Sponsor and not optional in nature and shall not be dependent on any notice being delivered to the Sponsor; and
- The Debenture Trustee shall give a prior notice of 60 days to the Sponsor in regards to the Mandatory Buy-out. However, the obligation of the Sponsor under the Mandatory Buy-out shall remain, independent of any such notice being given to the Sponsor.
- Sponsors’ liability: The liability of each Sponsor shall be limited to its proportionate shareholding in the Company, i.e. the Sponsors will not be joint and severally liable.

Accelerated Put Option available to the Investor (s)

- Accelerated Put Option may be exercised by the Investor(s) on the Sponsor in case of non-payment of coupon amount due and payable on the applicable Coupon Payment Dates wherein such default continues for a period of 1 (one) Business Days (including the Coupon Payment Date) from such Coupon Payment Date; and
- Accelerated Put Option shall be applicable on the entire outstanding principal amount of Debentures and any other dues due to the Investor(s).

Transfer

- In case of exercise of Accelerated Buy-out Option, the Sponsor, by itself, or through any other affiliate or Nominees (s) nominated by the Sponsor, may acquire the outstanding Debentures.
- In case of Mandatory Buy-out and/or the Accelerated Put Option, the Sponsor or its Nominees shall be mandatorily required to buy the outstanding Debentures held by the Investor(s).
- The Debentures, if required by the Principal Investor (s), maybe transferred only to the Permitted Investor at any time during the Tenure. Provided that such Permitted Investor (s) shall be permitted to transfer the Debentures to any of the Principal Investor (s)/ other Permitted Investor(s).

Conversion Option

The Debentures will not have any conversion option for the period it is held by the Investor(s). On exercise of any of the following, the conversion option shall be effective:

- Accelerated Buy-out Option;
- Mandatory Buy-out;
- Accelerated Put Option;

  Sponsor/ Nominee shall have the unilateral right to convert the Debentures held by them to equity of the Company.

Conversion Terms for Debentures

Debentures shall be automatically and compulsorily converted into ordinary equity shares of the Company at the end of the Tenure; provided however in the event that the Investors continue to hold the Debentures at the end of the Tenure, for any reason whatsoever, the conversion of the Debentures shall not happen until such time as the Sponsor has acquired the Debentures from the Investor. Further, in the event, the Sponsor exercises the Accelerated Buy-out Option or when the Debentures are transferred to Nominee(s), the Sponsor may require the Company to convert the Debentures including the coupon amount and any other fee paid to the Investor (s) by the Sponsor into ordinary equity shares of the Company, before the end of the Tenure of the Debentures. Such conversion shall occur at the Conversion Price.

Conversion Price

To be decided 35 months from date of issuance or within 30 days of the exercise of the following, whichever is earlier:

- Accelerated Buy-out Option;
- Mandatory Buy-out;
- Accelerated Put Option;

Ranking of shares

The equity shares issued upon conversion of the Debentures shall rank pari-passu in all respect with the equity shares existing at the time of such conversion, including with respect to voting rights, bonus and rights shares.

Query

On the basis of above, the opinion of the Expert Advisory Committee is sought on the following issues:

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- Whether the accounting treatment of CCDs issued by the Company and the disclosures made by the Company for the year ending 31st March 2020 is in line with the requirement of Ind AS 32 and the applicable provisions of other Indian Accounting Standards.
- In case, EAC opinion is contrary to accounting treatment adopted by the Company:
  - What is the correct accounting treatment that should have been followed in the matter?
  - What are the corrective or remedial actions to be taken by the Company in this respect?

Points considered by the Committee

The Committee notes that the basic issue raised by the company relates to the accounting treatment of the Compulsory Convertible Debentures (CCDs) issued by the Company and the related disclosures made in its financial statements for year ended 31st March 2020 under Ind AS. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case. The Committee has only looked into the issue from an Ind AS perspective and has not looked into the regulatory or legal classification and implications, including those arising under Income tax Act and FEMA. Further, the Committee presumes from the Facts of the Case that the interest/coupon rate in respect of the extant CCDs is at the prevalent market rate of interest for similar kind of instruments (having same terms, comparable credit status and cash flows, etc.).

The Committee notes that Ind AS 32, 'Financial Instruments: Presentation' states the following:

"15 The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.

16 When an issuer applies the definitions in paragraph 11 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.

- The instrument includes no contractual obligation:
  - to deliver cash or another financial asset to another entity; or
  - to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the issuer.
- If the instrument will or may be settled in the issuer's own equity instruments, it is:
  - a non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
  - a derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose, rights, options or warrants to acquire a fixed number of the entity's own equity instruments for a fixed amount of any currency are equity instruments if the entity offers the rights, options or warrants pro rata to all of its existing owners of the same class of its own non-derivative equity instruments. Apart from the aforesaid, the equity conversion option embedded in a convertible bond denominated in foreign currency to acquire a fixed number of the entity's own equity instruments is an equity instrument if the exercise price is fixed in any currency. Also, for these purposes the issuer's own equity instruments do not include instruments that have all the features and meet the conditions described in paragraphs 16A and 16B or paragraphs 16C and 16D, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

  A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D."

  "21 A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (eg an interest rate, a

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commodity price or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to Rs. 100, and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 ounces of gold. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.

22 Except as stated in paragraph 22A, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from equity. Changes in the fair value of an equity instrument are not recognised in the financial statements."

"28 The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability and an equity component. Such components shall be classified separately as financial liabilities, financial assets or equity instruments in accordance with paragraph 15.

29 An entity recognises separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and equity components separately in its balance sheet."

Appendix A, Application Guidance, Ind AS 32 Financial Instruments: Presentation

"AG27 The following examples illustrate how to classify different types of contracts on an entity's own equity instruments:

(a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument (except as stated in paragraph 22A). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognises a financial liability for the present value of the redemption amount (with the exception of instruments that have all the features and meet the conditions in paragraphs 16A and 16B or paragraphs 16C and 16D). One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.

(b) …

(c) …

(d) A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (eg a commodity price) is a financial asset or a financial liability. An example is a written option to buy gold that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than gold. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability."

Further, the Committee notes that Ind AS 109,

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'Financial Instruments' provides as follows:

"4.3.1 An embedded derivative is a component of a hybrid contract that also includes a non-derivative host— with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty, is not an embedded derivative, but a separate financial instrument."

"4.3.3 If a hybrid contract contains a host that is not an asset within the scope of this Standard, an embedded derivative shall be separated from the host and accounted for as a derivative under this Standard if, and only if:

- the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host (see paragraphs B4.3.5 and B4.3.8);
- a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
- the hybrid contract is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial liability at fair value through profit or loss is not separated)."

"Embedded derivatives (Section 4.3)

B4.3.1 When an entity becomes a party to a hybrid contract with a host that is not an asset within the scope of this Standard, paragraph 4.3.3 requires the entity to identify any embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently at fair value through profit or loss."

"B4.3.3 An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative."

The Committee notes from the above that the appropriate classification as a financial liability, equity or a combination of both, is determined by the entity when the financial instrument is initially recognised. The Committee notes that the exceptions in Ind AS 32, paragraphs 16A-D do not apply in the extant case. The Committee further notes that Ind AS 32 defines an equity instrument as any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. While classifying a financial instrument as a liability or equity, equity classification is appropriate only if the instrument fails the definition of a financial liability. In order for an instrument to be classified as an equity instrument under Ind AS 32, it is not sufficient that it involves the reporting entity delivering or receiving its own equity instruments. The number of equity instruments delivered, and the consideration for them, must be fixed ('fixed for fixed' requirement). Contracts that will be settled other than by delivery of a fixed number of shares for a fixed amount of cash do not meet the definition of equity. An entity may have a contractual obligation to deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be delivered equals the amount of the contractual obligation. Such a contract is a financial liability. Even though the contract must, or may, be settled through delivery of the entity's own equity instruments, the number of own equity instruments required to settle the contract will vary. The contract will therefore not fulfil the requirements of an equity instrument and is, therefore, a financial liability.

The Committee notes that in the extant case, interest is payable to the investors by the Company as per the terms of the CCDs, which in the view of the Committee, would meet the criteria for financial liability classification, since there is an obligation to pay cash that the issuer (the Company) cannot avoid (interest payment obligation). For this component, on a stand-alone basis, there is no feature that is similar to equity.

The Committee also notes from the Facts of the Case that the CCDs are convertible only in the hands of sponsors at the end of the tenure/buy-out option or exercising of put option by the investors and the Company would be required to convert the same into equity shares of the Company ranking pari-passu with existing shares at the time of conversion in the same proportion of shareholding /backstop support by reckoning share price at that time as per conversion formula defined in the transaction documents. The conversion option shall be effective on the exercise of the Accelerated Buy-out Option, the Mandatory Buy-out or the Accelerated Put Option

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giving the sponsor/ nominee an unilateral right to convert the debentures into equity of the Company.

Thus, with regard to conversion feature of the CCD, the Committee notes that in the extant case, there is no contractual obligation to pay cash that the issuer (the Company) cannot avoid, since the conversion into own equity shares is compulsory. However, the conversion ratio for the purpose of the conversion shall be dependent on the share price of the Company at the time of conversion. The equity conversion feature can only be settled through the issue of equity shares – however, there is an obligation to issue a variable number of shares – the number of shares to be issued is based on the share price on conversion. In other words, the conversion price and, hence, the conversion ratio of CCDs into ordinary equity shares of the Company is not fixed at the point of initial recognition of the CCDs. Therefore, the conversion component within the instrument would not meet the criteria laid down in Ind AS 32 for the purpose of classifying as equity. Accordingly, overall, the CCDs do not meet the criteria for being classified as compound instrument as there is no equity component. The CCDs should be classified as financial liabilities in entirety.

The Committee further notes that terms of the CCDs contain Accelerated Buy-out Option, or the Accelerated Put Option during the 35-month tenure of the CCDs. Upon exercise of these options by the Sponsors/ Investor, the Company would be required to convert the CCDs into equity shares. The Committee is of the view that these options may represent embedded derivatives under Ind AS 109, which should be evaluated by the Company in the extant case. Further, the Company shall also evaluate whether these embedded derivatives are ‘closely related’ to the host contract as per the requirements of Ind AS 109. The Committee notes that as per the requirements of Ind AS 109, for convertible notes with embedded derivative liabilities, the embedded derivative liability is determined first and the residual value is assigned to the debt host liability.

The Committee notes that the Company has provided the disclosures relating to CCDs in its financial statements for financial year ended 31st March 2020 based on compound instruments classification. The Company shall present and make the disclosures for the CCDs, as per the applicable requirements of Ind AS 32, Ind AS 107, Ind AS 113 and Division II – Ind AS Schedule III to the Companies Act, 2013 that are relevant for financial liabilities.

The Committee further notes that Ind AS 8, ‘Accounting Policies, Changes in Accounting Estimates and Errors’ states as follows:

“41 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with Ind ASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity’s financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are approved for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).

42 Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by: (a) restating the comparative amounts for the prior period (s) presented in which the error occurred; or (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.”

The Committee notes from the above that as per Ind AS 8, material prior period errors are corrected retrospectively by restating the comparative amounts for prior period(s) presented in which the error occurred. If the error occurred before the earliest period presented, the opening balance of assets, liabilities and equity/ retained earnings for the earliest period presented are adjusted. Therefore, the Company shall correct the accounting treatment of the CCDs as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error.

Opinion

On the basis of above, the Committee is of the following opinion on the issues raised in paragrap3 above:

- The accounting treatment of CCDs issued by the Company as compound instrument is not in line with the requirements of Ind AS 32, as discussed above. The disclosures in the financial statements shall be provided based on the classification as financial liabilities, as discussed above:
    - The CCDs shall be classified as financial liabilities in entirety under Ind AS 32, as discussed above.
    - The Company shall correct the accounting treatment of the CCDs as a prior period error retrospectively in the first set of financial statements approved for issue after the discovery of the error, as discussed above.

REGULATORY UPDATES

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Notification dated 6th December 2021: Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) (Third Amendment) Regulations, 2021 ("Amended Regulations")

SEBI has amended the regulatory framework for delisting of equity shares pursuant to open offer as provided under Regulation 5A of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 ("Takeover Regulations").

The key features of the revised framework are as follows:

- The acquirer may seek the delisting of the target company by making a delisting offer at the time of making open offer to acquire shares/voting rights/control of the target company in terms of Takeover Regulations.
- The acquirer needs to disclose its intention to delist the target company through the public announcement.
- If the acquirer is desirous of delisting the target company, the acquirer must propose a higher price for delisting with suitable premium over open offer price.
- In case the response to the open offer leads to the delisting threshold being met, all shareholders who tender their shares shall be paid the same delisting price. In case where the threshold is not met, all shareholders who tender their shares shall be paid open offer price.
- Where the delisting offer is not successful, on account of specified reasons, the acquirer shall, within 2 working days in respect of such failure, make a public announcement in the newspaper and comply with all the applicable provisions of these regulations.
- In cases where the target company fails to get delisted pursuant to a delisting offer but results in shareholding exceeding the maximum permissible non-public shareholding threshold, the acquirer may undertake a further attempt to delist the target company in next 12 months from the date of completion of the open offer. The success of such further delisting shall be subject to the conditions that the delisting threshold is met and 50% of residual public shareholding is acquired. Further, if the delisting is unsuccessful even in this extended period of 12 months, the acquirer, subsequently, must comply with the minimum public shareholding norm within a period of 12 months from the end of such period.
- At the time of open offer, if the acquirer has stated upfront its intention to retain the listing of the target company in the public announcement and the detailed public statement, the acquirer may alternatively undertake a proportionate reduction of the shares or voting rights to be acquired pursuant to (i) underlying agreement for acquisition / subscription of shares or voting rights and (ii) the shares tendered under open offer, in such a manner that the resulting shareholding of the acquirer in the target company does not exceed 75%.

Circular dated 22nd December 2021: Extension of facility for conducting meetings of unitholders of Real Estate Investment Trusts ("REITs") and Infrastructure Investment Trust ("InvITs") through VC or through OAVM

SEBI has extended the facility to conduct annual meetings and meetings other than annual meetings of unitholders of REITs and InvITs in terms of SEBI (REIT) Regulations, 2014 and SEBI (InvIT) Regulations, 2014 respectively, through VC/OAVM till 30th June 2022.

Circular dated 29th December 2021: Non-compliance with provisions related to continuous disclosures

To ensure the effective enforcement of various continuous disclosure obligations by issuers of listed Non-Convertible Securities ("NCS") and Commercial Papers ("CPs"), SEBI, in the past, vide its circular dated 13th November 2020 ("Previous Circular") had laid down a uniform structure for imposing fines upon non-compliance with such requirements.

Vide its recent circular dated 29th December 2021, SEBI has revised the fine structure to be levied upon non-compliances (given in Annexure I of this circular) and process flow on action to be taken in case of such non-compliances by issuers of listed NCS and CPs (given in Annexure II of this circular).

The fines specified in Annexure I of this circular shall continue to accrue till the time of rectification of the non-compliance and to the satisfaction of the concerned recognized stock exchange and such accrual shall be irrespective of any other disciplinary/enforcement action(s) initiated by recognized stock exchange(s)/SEBI.

This circular shall come into force for the due dates of compliances falling on or after 1st February 2022 and till that time, the Previous Circular would remain in force.

REGULATORY UPDATES

Circular dated 30th December 2021: Extension of timeline for modified reporting requirements for Alternative Investment Funds (“AIFs”)

SEBI, vide its previous circular dated 7th April 2021, allowed the AIFs to submit report on their activity on quarterly basis within 10 calendar days from the end of each quarter in the revised prescribed format through SEBI intermediary portal. Additionally, the circular also provided that the Category III AIFs shall submit report on leverage undertaken on quarterly basis. Both the above reporting requirements were made applicable on and from quarter ending 31st December 2021.

SEBI, vide this circular has now extended the applicability of above provisions on and from quarter ending 30th September 2022.

MINISTRY OF CORPORATE AFFAIRS (“MCA”)

Clarification on holding of Annual General Meeting (AGM) through Video Conference (VC) or Other Audio Visual Means (OAVM)

The MCA via General Circular dated December 08, 2021, has allowed the companies whose AGM are due in the year 2021, to conduct their AGM on or before 30th June 2022 in accordance with the para 3 and 4 of the general circular no. 20/ 2020 dated May 05, 2020 i.e. through VC and OAVM subject to satisfaction of conditions specified in this circular.

It is further clarified that this shall not be be considered as any extension of time for holding of AGMs by the companies under the Companies Act, 2013 (the Act) and the companies which have not adhered to the relevant timelines shall be liable to legal action under the appropriate provisions of the Act.

Various relaxations granted by MCA in view of difficulties arising due to resurgence of COVID-19

Clarification on holding Annual General Meeting (“AGM”) through Video Conference (“VC”) or Other Audio-Visual Means (“OAVM”)

In continuation of Circular No. 20/2020 dated 5th May 2020 and General Circular No. 02/2021 dated 13th January 2021, MCA permits companies to conduct their AGM, which were due to be held in the year 2021, on or before 30th June 2022.

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

Clarification on passing of Ordinary and Special resolution - Extension of timeline

MCA had issued a circular dated 8th April 2020 allowing companies to conduct their Extraordinary General Meeting (“EGM”) through VC or OAVM subject to certain conditions till 30th June 2020 on account of COVID-19. This was further extended till 31st December 2021. Now, MCA has further extended this relaxation till 30th June 2022.

Relaxation on levy of additional fees in filing of certain e-forms for the financial year ended 31st March 2021

MCA vide this circular has clarified that in respect of the financial year ended 31st March 2021, no additional fees shall be levied for filing certain e-forms like AOC-4, AOC-4 (CFS), AOC-4 XBRL, AOC-4 non-XBRL, up to 15th February 2022 and e-forms like MGT-7 / MGT-7A up to 28th February 2022.

RESERVE BANK OF INDIA (RBI)

Circular dated 8th December 2021: External Commercial Borrowings (ECB) and Trade Credits (TC) Policy – Changes due to LIBOR transition

The Foreign Exchange Management (Borrowings and Lending) Regulations (Notification No. G.S.R. 1213(E) [NO. FEMA 3(R)/2018-RB], dated 17th December 2018 provides the following:

- The benchmark rate for Foreign Currency (FCY) External Commercial Borrowings (ECB) / Trade Credit (TC) is 6-months LIBOR rate or any other 6-months interbank interest rate applicable to the currency of borrowing.
- All-in-cost ceiling for ECB is 450 basis points over the benchmark rate and that of TC is 250 basis points over the benchmark rate.

In view of the imminent discontinuance of LIBOR as a benchmark rate, the RBI, vide its circular dated 8th December 2021 has made the following changes to the benchmark rates and All-In-Cost (AIC) ceiling for FCY ECB / TC:

- **Benchmark rate of FCY ECB/TC** – It shall now refer to any widely accepted interbank rate or Alternative Reference Rate (ARR) of 6-month tenor, applicable to the currency of borrowings.
- **AIC ceiling for new FCY ECB/TC** - To consider differences in credit risk and term premia between LIBOR and the ARRs, the all-in-cost ceiling for new FCY ECB and TC has been increased by 50 bps over the benchmark rates. Accordingly, the AIC ceiling for new FCY ECBs would be benchmark rate + 500 basis points and for all new FCY TCs would be the relevant benchmark rate + 300 basis points.
- **One-time adjustment in AIC ceiling for existing FCY ECB/TC** - To enable a smooth transition of existing FCY ECBs/ TCs linked to LIBOR whose benchmarks are changed to ARRs, the all-in cost ceiling for such ECBs/ TCs has been revised upwards by 100 basis points to 550 bps and 350 bps, respectively, over the ARR.

Circular dated 10th December 2021: Introduction of Legal Entity Identifier (“LEI”) for Cross-border Transactions

With a view to harness the benefits of 20-digit LEI, RBI has introduced this circular providing for the followings:

- All resident entities (non-individuals) undertaking capital or current account transactions of INR 50 crores and

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above (per transaction) under Foreign Exchange Management Act, 1999 must provide LEI number to Authorized Dealer ("AD") Category I with effect from 1st October 2022.

- As regards non-resident counterparts/ overseas entities, in case of non-availability of LEI information, AD Category I banks may process the transactions to avoid disruptions.
- LEI number, once obtained, must be reported in all the transactions irrespective of its size.
- Further, AD Category-I banks shall have the required systems in place to capture the LEI information.
- Any LEI captured must be validated against the global LEI database available on the website of the Global Legal Entity Identifier Foundation.
- In India, LEI can be obtained from Legal Entity Identifier India Ltd. (LEIL) (https://www.ccilindia-lei.co.in), which is also recognized as an issuer of LEI by the RBI under the Payment and Settlement Systems Act, 2007.

Circular dated 14th December 2021: Prompt Corrective Action ("PCA") Framework for Non-Banking Financial Companies ("NBFCs")

Considering the growing size and substantial interconnectedness of NBFCs with other segments of financial system and to strengthen the supervisory tools applicable to all Deposit taking NBFCs (NBFCs-D), all Non-Deposit taking NBFCs (NBFCs-ND) in middle, upper and top layers, including Investment and Credit Companies, Core Investment Companies ("CICs"), Infrastructure Debt Funds, Infrastructure Finance Companies, Micro Finance Institutions and Factors, the RBI has introduced a PCA framework to enable supervisory intervention at appropriate time.

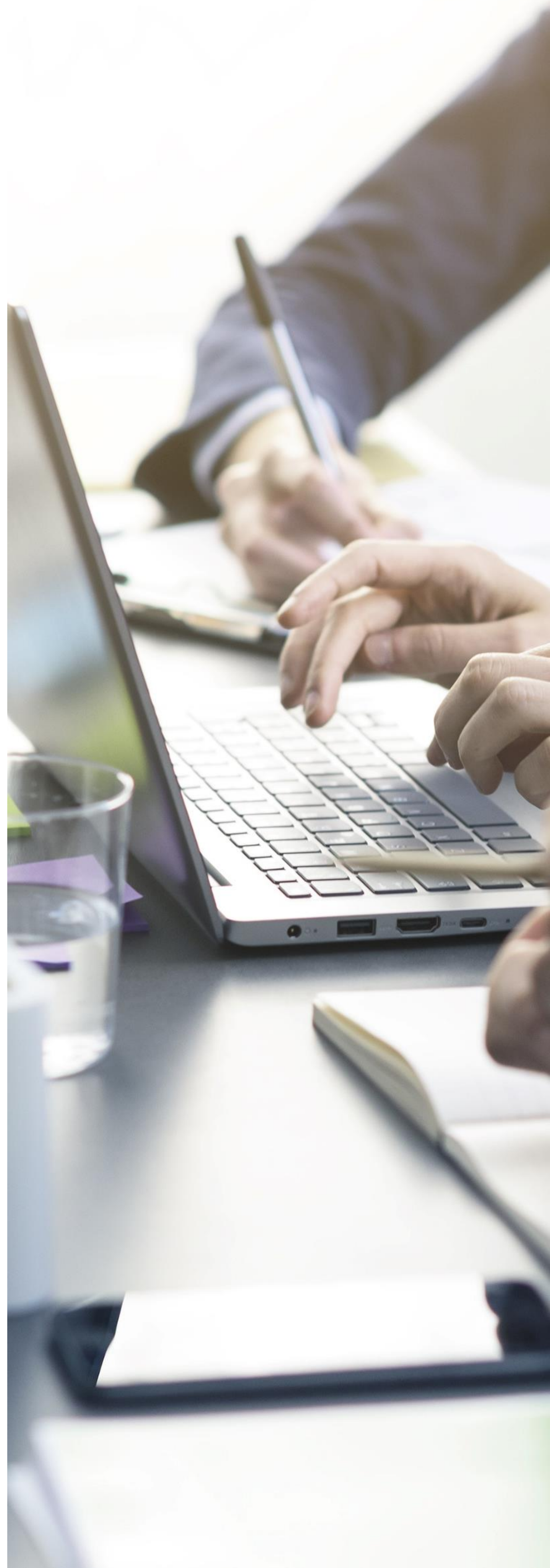
For NBFCs-D and NBFCs-ND,

- Capital and Asset Quality would be the key areas for monitoring in PCA Framework and
- indicators to be tracked would be Capital to Risk Weighted Assets Ratio (CRAR), Tier I Capital Ratio and Net NPA Ratio (NNPA).

For CICs,

- Capital, leverage, and asset quality would be the key areas for monitoring in PCA Framework.
- indicators to be tracked would be Adjusted Net Worth / Aggregate Risk Weighted Assets, Leverage Ratio and NNPA.

A PCA Framework would be made applicable based on the audited annual financial results and/or the supervisory assessment made by the RBI except for cases, where it can also be imposed if the circumstances so warrant. Further, a PCA Framework shall come into effect from 1st October 2022, based on the financial position of NBFCs on or after 31st March 2022.



TAX UPDATES
Direct Tax

CIRCULARS/ NOTIFICATIONS/PRESS RELEASE

Central Board of Direct Taxes notifies conditions to claim exemption on transfer of Non-Deliverable Forward Contracts in IFSC.

The Finance Act 2021 had inserted a new clause (4E) under section 10 of the Income-tax Act, 1961 (IT Act) to exempt, subject to certain conditions, any income accrued or arisen to, or received by a non-resident if such income is a result of transfer of non-deliverable forward contracts and such contracts are entered into with an offshore banking unit of an International Financial Services Centre (IFSC). In view of the above and to provide impetus to IFSC, the Central Board of Direct Taxes (CBDT) has now issued a notification to insert Rule 21AK to the Income-tax Rules, 1962 (IT Rules), prescribing conditions for availing the exemption and to clarify a few expressions, especially the term "Non-Deliverable Forward Contracts".

To read BDO analysis of the CBDT notification, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-notifies-conditions-to-claim-exemption-on-transfer-of-non-deliverable-forwar

[Notification No. 136 of 2021 (F.NO. 370142/53/2021-TPL dated 10 December 2021]

CBDT notifies e-Verification Scheme.

Section 135A in the IT Act provides for faceless collection of information. The section empowers the Central Government to make a Scheme for the purpose of collecting information of taxpayers by the Tax Officer. In this regard, the Central Board of Direct Taxes has recently notified the e-Verification Scheme, 2021 to impart greater efficiency, transparency and accountability in the assessment proceedings

To read BDO analysis of the CBDT circular, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-notifies-e-verification-scheme

[Notification No. 137 of 2021 (F.NO. 370142/57/2021-TPL dated 13 December 2021]

CBDT notifies rule for computation of exempt income of specified fund for section 10(23FF) of the IT Act.

The Finance Act, 2021 inserted clause (23FF) in section 10 of the IT Act providing exemption to funds established in India and registered as Category III Alternative Investment Fund in IFSC (specified funds) on income earned in the nature of capital gains arising from transfer of shares of an Indian company by a resultant fund in IFSC. The methodology for determining the amount of exempt capital gains was to be prescribed. The CBDT has now issued a

notification inserting new Rule 2DD to the IT Rules to provide the following mechanism to compute capital gains exempt from taxes.

Income exempt as per Section 10(23FF) of the IT Act = A*B/C, where:

- A = Capital gains, arising or received by a specified fund, on account of transfer of shares of a company resident in India, by the specified fund and where such shares were received by the specified fund, being resultant fund, in relocation from the original fund, or from its wholly owned special purpose vehicle, and where such capital gains would not be chargeable to tax if the relocation had not taken place;
- B = Aggregate of daily assets under management (AUM) of the specified fund which are held by non-resident unit holders (not being the permanent establishment of a non-resident in India), from the date of acquisition of the share of a company resident in India by the specified fund to the date of transfer of such share.
- C = Aggregate of daily total assets under management (AUM) of the specified fund, from the date of acquisition of the share of a company resident in India by the specified fund to the date of transfer of such share. The specified fund has to electronically file Form 10-II (annual statements of exempt income) as per Rule 2DD(2) of the IT Rules on or before the due date of filing return of income to claim income from capital gains exempt from taxes. In case, Form 10-II is not filed then exempt income shall be considered as NIL. Further, Form 10-II shall be certified by an accountant in Form 10-IJ electronically, one month prior to the due date of filing Form 10-II. The Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), shall specify the procedure for filing Form 10-II and Form 10-IJ.

  [Notification No. 138 of 2021 (F. NO. 370142/58/2021-TPL dated 27 December 2021]

CBDT provides one-time relaxation for verification of income tax returns filed for AY 2020-21.

Upon e-filing of return of income (ROI), taxpayers have to verify the same within 120 days of filing. The verification can be done through the following modes:

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- Through Aadhaar OTP;
- By logging into e-filing account through net banking;
- EVC through Bank Account Number;
- EVC through Demat Account Number;
- EVC through Bank ATM;
- By sending a duly signed physical copy of ITR-V through post to the CPC, Bengaluru.

CBDT's attention was drawn to the fact that large number of ROIs are yet to be verified. In such a scenario, the ROIs not verified within the prescribed time limit will render the ROI filed to be non-est. Therefore, CBDT in exercise of its powers have allowed the taxpayers where ROIs have been declared non-est or the verification of e-filed ROIs are pending to be completed on or before 28 February 2022 as per the prescribed modes.

However, the above relaxation will not be available to those taxpayers where the tax department has already taken action after declaring the ROI filed as non-est. Further, CBDT has relaxed the time frame for issuance of intimation under Section 143(1) of the IT Act and has extended the date for processing such returns till 30 June 2022. Interest on refund as per Section 244A(2) of the IT Act will be applicable to all the ROIs verified during this period.

[Circular No. 21/2021, dated 28 December 2021]

CBDT notifies Faceless Appeal Scheme, 2021.

CBDT notified Faceless Appeal Scheme, 2021 in supersession of the Faceless Appeal Scheme, 2020 with effect from 28 December 2021. The Scheme 2021 carves out an exception for acts done or omitted under the erstwhile Scheme and further addresses several issues under the erstwhile Scheme.

To read BDO analysis of the CBDT circular, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-faceless-appeal-scheme,-2021-notified

[Notification No. 139 of 2021 (F. NO. 370142/66/2021-TPL dated 28 December 2021]

CBDT notifies rule for claiming deduction under Section 10A of the IT Act.

Section 10A(1A) of the IT Act is a special provision which provides for deduction of profits and gains derived by an undertaking in the Special Economic Zones (SEZ) from manufacturing or producing of articles or things or computer software on fulfillment of the prescribed conditions. As per the conditions laid down, the taxpayer is required to create a SEZ Reinvestment Allowance Reserve out of the profits earned and furnish details of new plant or machinery purchased from such reserve along with the ROI in the prescribed manner.

In this regard, the CBDT has now issued a notification inserting new Rule 16DD in the IT Rules prescribing Form 56FF to furnish following details to claim the deduction:

- Details of SEZ Reinvestment Allowance Reserve Account; and
- Details of new plant/machinery purchased out of amounts withdrawn from SEZ Reinvestment Allowance Reserve Account.

[Notification No. 140 of 2021 (F. NO. 370142/59/2021-TPL dated 29 December 2021]

JUDICIAL UPDATES

Education cess is not a deductible expenditure

Taxpayer, a public limited company, is into the manufacturing of chemical intermediates. Tax return of the fiscal year (FY) 2011-12 was selected for tax assessment. Tax Officer completed the assessment after making certain disallowances. As the First Appellate Authority (Authority) granted entire relief, the Revenue Authorities filed an appeal against the order of the Authority before the Tax Tribunal. The taxpayer filed cross appeals and also, filed an additional ground of appeal to allow education cess as a deductible expense while computing the total income. Before the Tax Tribunal, the taxpayer submitted the following:

- Section 40(a)(ii)[1] of the IT Act does not explicitly include education cess and is an allowable expense.
- Reliance was placed on CBDT Circular[2] wherein it has been stated that the word cess was omitted from the provisions of Section 40(a)(ii) of the IT Act and therefore, 'cess' is an allowable expense.
- Further, the taxpayer relied on various judgements[3] including that of the jurisdictional Tax Tribunal wherein reliance was placed on the above-mentioned CBDT Circular and allowed education cess as a tax-deductible expense.

The Tax Tribunal concluded that education cess is in the nature of additional surcharge and therefore, should not be allowed while computing the total income of the taxpayer.

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[1] 40(a)(ii). any sum paid on account of any rate or tax levied on the profits or gains of any business or profession or assessed at a proportion of, or otherwise on the basis of, any such profits or gains.

Explanation 1.—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes and shall be deemed always to have included any sum eligible for relief of tax under section 90 or, as the case may be, deduction from the Indian income-tax payable under section 91.

Explanation 2.—For the removal of doubts, it is hereby declared that for the purposes of this sub-clause, any sum paid on account of any rate or tax levied includes any sum eligible for relief of tax under section 90A.

[2] CBDT Circular No. 91/58/66-ITJ(19) dated 18 May 1967

[3] Bombay High Court in the case of Sesa Goa Limited Vs. JCIT [(2020) 117 taxmann.com 96]
Rajasthan High Court in the case of Chambal Fertilizers & Chemicals Ltd Vs. JCIT [D.B Income-tax Appeal No. 52/2018]
Kolkata Tribunal in the cases of DCIT vs. ITC Infotech India Ltd [ITA No. 67/Kol/2015], Tega Industries Ltd vs. ACIT [ITA No. 404/Kol/2017] and SREI Infrastructure Finance Ltd vs. Addl. CIT [R-9, ITA No. 1318/Del/2012]

[4] CIT vs. K. Srinivasan [(1972) 83 ITR 346]

[5] Finance Act, 2004 - "An additional surcharge, to be called the Education Cess to finance the Government's commitment to universalise quality basic education, is proposed to be levied at the rate of two per cent on the amount of tax deducted or advance tax paid, inclusive of surcharge."

TAX UPDATES
Direct Tax

While coming to this conclusion, the Tax Tribunal referred to Supreme Court judgement[4] and made following observations:

- Surcharge as per the Webster's New International Dictionary among other definitions means "to charge (one) too much or in addition" also "additional tax". Therefore, the definition of income-tax as per Finance Act, 1963 would mean that income tax and super tax includes basic tax, surcharge, special surcharge and additional surcharge, resulting in additional tax being part of income tax and super tax.
- Education cess was introduced through Finance Act, 2004[5] which stated that education cess is an additional surcharge.
- The above was reiterated in Finance Act, 2011[6], stating income-tax chargeable will further be increased by an additional surcharge, i.e., education cess.

  [Kanoria Chemicals & Industries Ltd {TS-1129-ITAT-2021(Kol)}]

FTC to be allowed on employee salary earned in Australia, holds the requirement to furnish Form 67 as directory.

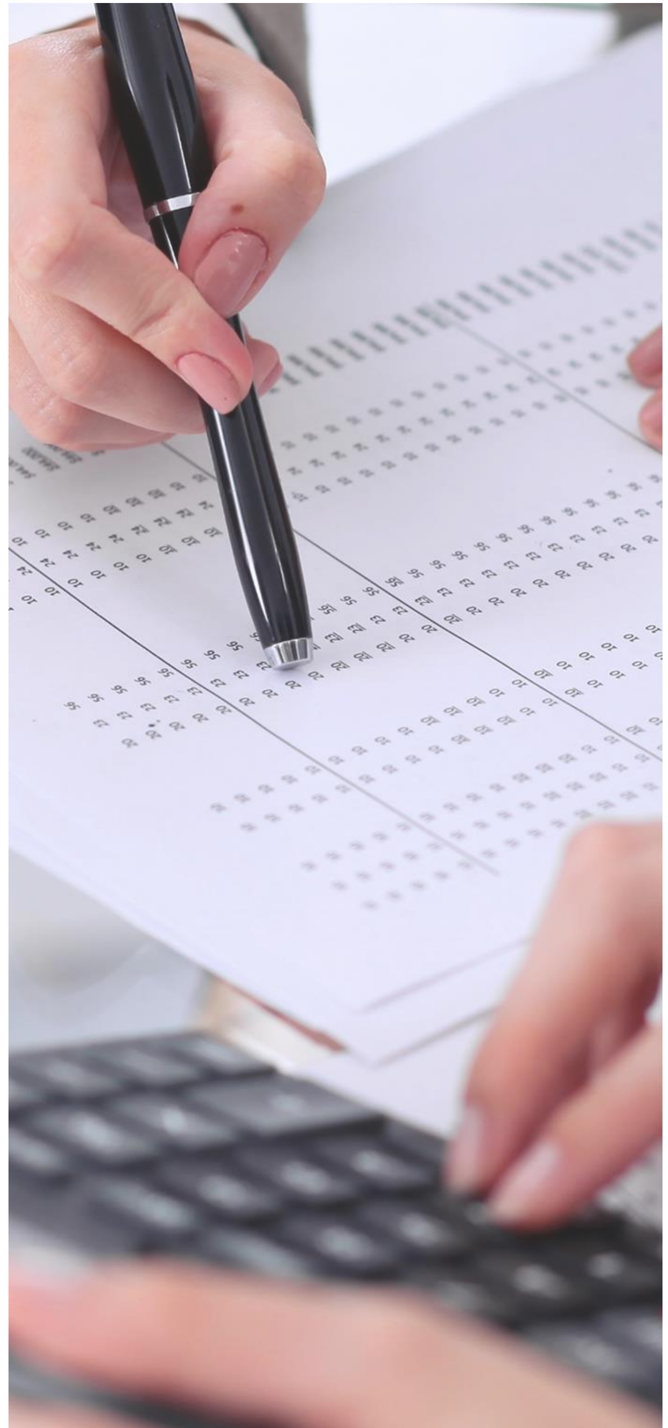
Rule 128 of Income tax Rules, 1962 (IT Rules) prescribes that a "statement of income earned outside India and foreign tax credit" is required to be furnish in Form No. 67 for claiming FTC. Recently, Bangalore Tribunal held that the furnishing of Form 67 is directory in nature.

To read BDO analysis please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-bangalore-itat-allows-ftc-to-employee-on-salary-earned-in-australia,-holds-the-re

Revised return can be filed manually where the NCLT's sanction date is after the expiry of deadline for revised return.

Sometimes, Scheme of Arrangement is sanctioned only after the expiry of timeline for revising the return of income. In such instances, the taxpayer would face technological challenges in filing a revised tax return, viz., with e-filing of tax return on income tax portal being made mandatory for all Companies, as the system will not permit a taxpayer to file revised return after the expiry of the deadline. Hence, the only option available with the taxpayer is to file the revised return manually. A question may arise on its validity. Recently, the Gujarat High Court had an occasion to delve on a similar matter.

To read BDO analysis please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-revised-return-can-be-filed-manually-where-the-nclt%E2%80%99s-sanction-date-is-after-the



[6] **Finance Act, 2011** – "2(11) The amount of income-tax as specified in sub-sections (1) to (10) and as increased by a surcharge for purposes of the Union calculated in the manner provided therein, shall be further increased by an additional surcharge for purposes of the Union, to be called the "Education Cess on income-tax", calculated at the rate of two per cent. of such income-tax and surcharge, so as to fulfil the commitment of the Government to provide and finance universalised quality basic education."

TAX UPDATES
Transfer Pricing

Non charging of interest on loan to subsidiary during the moratorium period attracts TP adjustment:

The taxpayer is a company engaged in the business of manufacture of enzymes and pharmaceutical ingredients. It had advanced loan to its subsidiary in Switzerland during the first year of operation of the subsidiary. The loan carried a moratorium period of 11 months, post which interest @ 3% pa or LIBOR during the term of the loan plus 1% whichever is higher was chargeable.

The taxpayer contended that there is no accrual of income in the hands of the taxpayer during moratorium period and hence, hypothetical interest income cannot be recognized as income. The taxpayer also placed reliance on the RBI Circular on moratorium dated 01 July 2015.

The Bangalore bench of the Tribunal held that expression 'debt arising in the course of business' as appearing in the definition of international transaction under section 92B of the Income-tax Act, 1961 (Act) refers to trading debt arising from sale of goods or service rendered in the course of carrying on business. Once any debt arising in the course of business is an international transaction, any delay in realization of the same needs to be considered within transfer pricing adjustment, on account of interest income short charged or uncharged. Further, the RBI Circular was meant to apply only for specific loans for industrial projects or for agricultural plantations etc. Accordingly, ITAT noted that any delay in realization of trading debt needs to be considered within transfer pricing adjustment.

The taxpayer raised an alternative argument of working capital adjustment instead of computing interest on loan. The Tribunal relied on the judgement of the Delhi Tribunal in the case of Orange Business Services India Solutions Pvt Ltd Vs DCIT [(2018) 91 taxmann.com 286] and remitted the matter to the TPO to decide the case in conformity with this judgement.

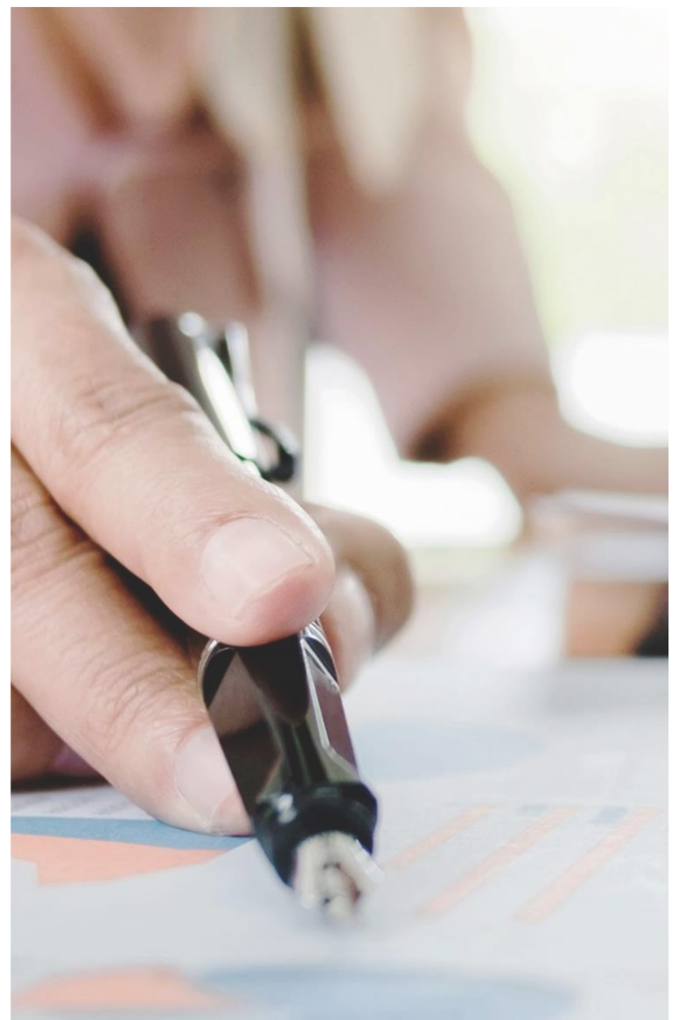
Biocon Ltd Vs. DCIT [TS-652-ITAT-2021(Bang)-TP]

Assessment Order passed pursuant to DRP Directions cannot be revised by CIT u/s 263:

The original assessment order in the instance case was passed under section 143(3) read with section 144C(13) on the basis of the directions of the DRP. The CIT invoked revision under section 263 of the Act. The taxpayer challenged the revision of assessment order by CIT since assessment order was passed pursuant to DRP directions (which consist of 3 commissioners).

Based on an analysis of revisionary powers under section 263 and explanation therein (which also provides for revision of assessment orders passed on the direction of superior officers in certain cases), the Mumbai bench of the Tribunal observed that an order passed pursuant to DRP directions under section 144C is excluded from such revisionary proceedings. Consequential amendments made to various sections on insertion of section 144C did not include amendments to sec 263. The Tribunal relied on the judgment of the Supreme Court in **Supertech Limited v. Emerald Court Owner Resident Welfare Association and Ors, and** held that If the AO could not have directly made any change in the final assessment order after the direction of the DRP, then the PCIT also cannot indirectly make any change so as to circumvent the provision of section 144C(13) of the Act. Referring to the constitution of DRP, the Tribunal ranked 3 members DRP (who are individually equivalent in rank of the CIT) to be superior to CIT. The Tribunal observed that the DRP stands at a higher pedestal than the CIT passing an order alone. The Tribunal also rejected the Revenue's stand that DRP proceedings are akin to appeal proceedings before the CIT(A). Accordingly, the Tribunal concluded that CIT could not legally assume jurisdiction u/s. 263 over an order passed by the AO pursuant to the direction of DRP.

Barclays Bank PLC Vs. CIT [TS-03-ITAT-2022(Mum)-TP]



TAX UPDATES
Indirect Tax

GOODS & SERVICE TAX

JUDICIAL UPDATES

ORDERS BY AUTHORITY FOR ADVANCE RULING (AAR)

Place of Supply of services rendered in respect of goods that are being exported

Facts of the case

M/s. International Inspection Services Private Limited ('IISPL' or 'Taxpayer') is engaged in supply of inspection services during the manufacturing of equipment and packing of equipment/material both in India and abroad. The taxpayer also performs inspection services for foreign clients in respect of the equipment/machinery/material in India but which is intended to be exported out of India and receive inspection charges in foreign currency.

Questions before the AAR

- Whether services rendered for foreign companies (which do not have any business place/agency in India) in India is considered as an export or not?
- Whether services provided in respect of goods that are being exported are also considered as export of services?

Observations & Ruling by the AAR

- The taxpayer performs services in relation to goods located or under manufacture in the territory of India on behalf of the foreign buyer. The liability to tax in this situation is governed by the place of supply provisions as enumerated under section 13 of the IGST Act, 2017. This section deals with place of supply of services where location of supplier or location of recipient is outside India. Sub section 3 of section 13 reads as follows:

  "3. The place of supply of the following services shall be the location where the services are actually performed, namely:

  - Services supplied in respect of goods which are required to be made physically available by the recipient of services to the supplier of services, or to a person acting on behalf of the supplier of services in order to provide the services."
- It can be observed that in the instant case, the location of the recipient is outside India, however the location where the services are actually performed in respect of goods is in the country. Therefore, the place of supply of services provided by the taxpayer are within the country and hence liable to SGST & CGST in the State of Telangana;
- For the first question the AAR held that place of supply of services provided by the taxpayer are within the country and hence liable to SGST & CGST and will not be treated as export;
- The above ruling would also be applicable for the second question.

  [AAR-Telangana-M/s. International Inspection Services Private Limited-A.R.Com/06/2020 TSAAR Order no:33/2021 dated 29 December 2021]

Applicable rate of GST for the manufacturing of sweet and namkins and selling the goods over counter by composition taxpayers

Facts of the case

- M/s. Chikkaveeranna Sweet Stall, ('taxpayer) is is a proprietorship concern registered under the provisions of CGST Act, 2017 as well as Karnataka GST Act, 2017;
- The taxpayer is running sweet stall and is engaged in manufacturing of sweets and doing counter sale on retail basis. The sweet stall does not have any restaurant or hotel;
- Presently, the taxpayer is paying 1% tax under composition scheme on total turnover as he is a manufacturer of sweets and not providing any goods for human consumption at the stall.

Questions before the AAR

For composition taxpayers what is the applicable rate of GST for the manufacturing of sweet and namkeens and selling the goods over the counter not having any facility of restaurant or hotel or not a part thereof and not giving for human consumption at the place of shop?

Contention of the Taxpayer

- The taxpayer stated that he is running sweet stall and is engaged in manufacturing the sweets and doing counter sale on retail basis. He also stated that he is registered as "Composition Taxpayer" under GST and selling the goods over the counter and not having the facility of restaurant or hotel;
- The taxpayer stated that at present they are paying 1% composition tax on total turnover, as he is a manufacture of sweets and not providing any goods for human consumption at the place of shop.

Observations & Ruling by the AAR

- As per notification no:8/2017-CT dated 27 June 2017, an eligible registered person, whose aggregate turnover in the preceding financial year did not exceed INR 7.5Mn, may opt to pay, in lieu of the tax payable by him, calculated at the rate of one percent of the turnover in state in case of a manufacture;

TAX UPDATES
Indirect Tax

- Since the taxpayer is into manufacture of sweets, he can opt to pay GST at one percent of the turnover subjected to the condition mentioned in the notification no:8/2017-CT dated 28 June 2017 and further amended notifications;
- The AAR held that the rate of GST applicable for a composition taxpayer who are engaged in the manufacture of sweet and namkeens and who is doing only the counter sales, is 1% (0.5% CGST and 0.5% SGST) subjected to the condition mentioned in the notification no:8/2017-CT dated 28 June 2017 and further amended notifications.

  [AAR- Karnataka, M/s. Chikkaveeranna Sweet Stall, Ruling no:KAR ADRG 79/2021, dated 31 December 2021]

Part recovery for cab services from employees transport facility is not taxable

Facts of the case

- M/s. Integrated Decisions and Systems (India) Private Limited ('Taxpayer') is located in Maharashtra and primarily engaged in providing software development and support services to its holding company located outside India, wherein it provides transportation facility to its employees;
- Services are being provided for security of staffs hence, taxpayer is availing renting of motor vehicles or cab. In such cases, the taxpayer initially pays the entire amount and subsequently as per policy of the company, partial amount is recovered from the respective employees. The Input Tax Credit (ITC) in this respect is not being availed by the taxpayer.

Questions Before the AAR

- Whether part recovery of cab services from employees in respect of the transport facility provided to them would be treated as 'supply' as per provision of GST and whether GST is leviable on the same?
- What would the value of said supply be, in case taxable, keeping in mind that employee and the taxpayer are related party as per provisions of GST law?
- Whether ITC is admissible in respect of GST paid on inward supply of renting of cab service which are used for the employee?

Contentions of the Taxpayer

- The taxpayer is providing support services for software and not providing cab services to employees. It is a mere welfare and safety measure. As required by section 7 of CGST Act, 2017 to constitute a 'Supply', the same should be in furtherance of business and for consideration;
- In the present case, there is no furtherance of business and in fact no consideration but recovery of partial amount only, which is reimbursement of expenses;
- Thus, as per the taxpayer, the transaction between the company and their employee are not supply of service & hence not liable to GST;
- The taxpayer also referred to the case of Posco India Pune Processing Center (P.) Ltd [GST-ARA-36/2018-19/B-110] wherein AAR Maharashtra held that as Posco India is not rendering any service of health insurance to their employee, there is no supply of service;
- Reference was also made to the case of M/s. North Shore Technologies P. Ltd. [2021 (49) G.S.T.L. 315 (A.A.R. GST-UP.)] wherein was held that, providing transport facility to its employees cannot said to be in furtherance of business and would not be considered as supply under GST;
- However, even in case GST is payable by the taxpayer, as employee and employer are treated as related persons, the value shall be determined as per section 15 CGST Act, 2017 read with rule 28 of CGST Rules, 2017 wherein open market value is the value of supply on which the company has to pay GST to cab renting company. Hence, GST is to be paid on full value of service;
- Further, as per section 16 of the CGST Act, 2017, every registered person shall be eligible to take ITC of GST paid on goods or services used or intended to be used in the course or furtherance of business;
- Also, the same is not blocked under section 17(5) in case inward supply of such service is used for making an outward taxable supply of the same category of service or as an element of a taxable composite or mixed supply;
- The taxpayer submitted that if recovery of renting of motor vehicles has been considered as supply, then the respective ITC should be allowed as the same is used to provide outward supply of the same nature.

Observations and ruling by the AAR

- The provision of transport facility to the employees is not an activity which is incidental or ancillary to the activity of software development, nor can it be called an activity done in the course of or in furtherance of development of software, also it is not integrally connected to the business in such a way that without this the business will not function;
- Further the transport or rental of vehicle service is also not the output service of the taxpayer since they are not in the business of providing transport service;
- In the instant case, the taxpayer is not providing transportation facility to its employees, in fact the taxpayer is a receiver of such services as partial amount is recovered by the taxpayer from its employees in respect of use of such transport facility which form part of the total amount paid to the third-party vendors on which GST has been levied;

TAX UPDATES
Indirect Tax

- The reference was made to the ruling of AAR Maharashtra in the case of M/s. Tata Motors Limited [GST-ARA-23/2019-20/B-46] wherein it was held that GST is not applicable on such nominal amounts recovered from its employees for usage of transportation facility;
- Hence the service in the instant case does not qualify to be a supply, thus not taxable under GST.

[AAR-Maharashtra, M/s. Integrated Decisions and Systems (India) Private Limited, Ruling no:GST-ARA-116/2019-20/B-113, dated 16 December 2021]

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