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INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

EAC OPINION

DISCLOSURE OF CHANGES IN INVENTORY OF SCRAP IN THE STATEMENT OF PROFIT AND LOSS

Facts of the Case:

A Company (hereinafter referred to as 'the Company') is a listed central public sector company formed under the Ministry of Defence. The Company has been set up with a view to achieving self-reliance in the production and supply of various super alloys, titanium alloys, maraging steel and special steel materials to Defence and other strategic sectors for nuclear, aeronautical and space applications. The products manufactured are sold in the form of ingots, forged billets, sheets, plates, strips, rods, rings, etc.

The Company has stated that scrap is predominantly generated from the Company's each manufacturing process, i.e. melting, forging and machining, etc. Further, with regard to the nature of scrap, 90% of the scrap generated during the manufacturing process will be reusable in the production process of melting and only 10 % of scrap, such as turnings/end cut scrap, etc. is sold in the open market.

The Company's production process starts from primary melting where Company uses various raw materials purchased as per required composition/specifications for an end product in the melting process and the internally generated scrap is also used in the majority volume based on the requirement.

Existing Practice:

The Company has further stated that the net accretion/decretion in scrap stock, i.e. difference of closing stock and opening stock of scrap is booked as 'Consumption of raw material internally generated scrap' and the same is grouped under 'Cost of Material Consumption' in the Statement of Profit and Loss. The closing stock of scrap is disclosed under 'Note 10 – Current Assets (Inventories)' at an estimated realisable value of scrap. The sale of scrap is being shown separately under 'Other Operational Income' under revenue from operations in the Statement of Profit and Loss.

During the reporting period, if scrap generation is more than the scrap consumption, the 'consumption of raw material – internally generated scrap' shows credit balance thereby reducing the amount of raw material consumption and vice-versa, i.e. if scrap consumption is more than the scrap generation, the consumption of internally generated scrap shows the debit balance (net off scrap generation).

The Company has given the rationale for the existing practice as follows:

- Scrap generated during the manufacturing process is reusable as a raw material in the production process of melting.
- Paragraph 9.5.3 of the Guidance Note on Division II – Ind AS Schedule III to the Companies Act, 2013, issued by the Institute of Chartered Accountants of India (ICAI) requires disclosure of difference in opening and closing inventories of finished goods (FG)/Work-in-Progress (WIP)/Stock-in-trade only in 'changes in inventories of finished goods and work-in-progress'.
- No guidance is available regarding the disclosure of changes in scrap inventory in the Guidance Note or in the Standard.

- In the absence of any guidance for disclosing the accretion/ decretion of scrap, the same is being consistently shown as part of raw material consumption for the past several years.

According to the Company, as per a recent opinion given by the Expert Advisory Committee (EAC) of the ICAI dated 7 May 2021 (published in May 2021, ICAI Journal), when scrap generated during the manufacturing process is not usable & there is no other use of such items except disposal as scrap, such scrap inventories can be shown as 'Changes in Inventory of Scrap' in Statement of Profit and Loss.

During recent deliberations in the Company, it was discussed that consumption of raw material – internally generated scrap shows a credit balance when scrap generation is more than the consumption and this resulted in an understatement of raw material consumption for the particular period.

It is also submitted by the Company that the materials procured and used in the manufacturing process will be considered as raw material consumption. The raw materials may be basic raw materials required for the production process. Further, any material which is in the form of an intermediary product, if purchased, is also being treated as raw material and whenever such material is consumed, the same is shown as raw material consumption. However, in case of intermediary products produced and re-used in the subsequent process, these will always affect the inventory accretion/ decretion, i.e. intermediary items in the stock if it is increasing work-in-progress (WIP) over the period, beginning and ending and vice versa.

It is also to be noted that the value of scrap generation/ consumption clubbing under raw material consumption affects certain ratios which are required to be calculated for Memorandum of Understanding (MOU) purposes. The Department of Public Enterprise (DPE) confirmed that all ratios are to be arrived based on accounts as published. Sometimes certain WIP which is good will be changed to scrap due to rejection or sale as scrap and such adjustments affect the figures of change in inventory and raw material consumption.

For easy understanding of the issue, the present practice followed in the Company and proposed practice are tabulated by the Company as below:

Present Practice

Description	Journal Entry	Grouping in Statement of P&L
Increase in Scrap Inventory (Scrap generation is more than consumption)	Scrap Inventory A/c Dr. Consumption of Raw Material – Internally generated scrap Cr.	Cost of Raw Material Consumption
Decrease in Scrap Inventory (Scrap consumption is more than generation)	Consumption of Raw Material – Internally generated scrap A/c Dr. Scrap Inventory Cr.	Cost of Raw Material Consumption

Proposed Practice

Description	Journal Entry	Grouping in Statement of P&L
Increase in Scrap Inventory (Scrap generation is more than consumption)	Scrap Inventory A/c Dr. Changes in Scrap Inventory Cr.	Changes in Finished Goods/ Work-in-progress
Decrease in Scrap Inventory (Scrap consumption is more than generation)	Changes in Scrap Inventory A/c Dr. Scrap Inventory Cr.	Changes in Finished Goods/ Work-in-progress

Practical Example for present and proposed practice in the Statement of Profit and Loss

Cost of Raw Material Consumption

Existing		Proposed	
Description	**Amount (Rs.)**	**Description**	**Amount (Rs.)**
Gross Raw Material consumption (Direct purchase from Market)	100,000	Gross Raw Material Consumption (Direct purchase from the market)	100,000
Add:			
(Accretion)/Decretion of Scrap value (Opening – Closing)	**(30,000)**		**-**
Net Raw Material Consumption	**70,000**		**100,000**

Changes in Inventory of Finished goods/Work-in-progress

Existing		Proposed	
Description	**Amount (Rs.)**	**Description**	**Amount (Rs.)**
Change in Inventory of FG and WIP (Increase)	(200,000)	Change in Inventory of FG and WIP	(200,000)
Add			
(Increase) / Decrease in Scrap	**-**		**(30,000)**
Change in Inventory of FG and WIP	**(200,000)**		**(230,000)**

It is also informed that there is no change in the total expenses and profit amount under both practices.

Query:

The Company has sought the opinion of the Expert Advisory Committee as to whether the Company can change the grouping of net scrap generated under 'Change in Inventories of finished goods, work-in-progress and stock-in-trade' instead of 'Cost of Raw Material Consumption' in the Statement of Profit and Loss.

Points considered by the Committee

The Committee notes that the basic issue raised by the Company relates to the presentation of the inventory of items/products (classified as 'scrap'), generated during the manufacturing process and consumed/used in the further production process of the Company, in the Statement of Profit and Loss. 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, while expressing its opinion has laid down the accounting principles to be followed and has not examined the appropriateness/accuracy of journal entries and the example furnished by the Company for present & proposed practice in the Statement of Profit and Loss. Committee wishes to point out that the Accounting Standards referred hereinafter are Indian Accounting Standards, notified under the Companies (Indian Accounting Standards) Rules, 2015, as amended/ revised from time to time.

"At first, the Committee examines the nature of items/products (classified as 'scrap') in the extant case in the context of accounting requirements and notes the following paragraphs of Indian Accounting Standard (Ind AS) 2, 'Inventories':

"6 Inventories are assets:

- held for sale in the ordinary course of business;
- in the process of production for such sale; or
- in the form of materials or supplies to be consumed in the production process or in the rendering of services."

"A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable or after production. Most by-products, by their nature, are immaterial.

When this is the case, they are often measured at net realisable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost."

From the above, the Committee notes that during a production process, more than one product may be produced simultaneously which, for example, may either be joint products or a main product and a by-product. Further, although the Standard does not mention about scrap or waste products; the Committee notes that scrap or waste products are also the results of the production process and if these could be sold or used/consumed internally, these can be considered as 'inventories'. In this context, the Committee also notes that the items/products generated/produced during the manufacturing process in the extant case are either used in further production processes or sold in the open market. Therefore, the Committee is of the view that materials/items generated in the manufacturing process which would be further used as input in the production process of melting can be considered to be 'in the process of production for sale' and accordingly, can be considered as 'inventories' as per paragraph 6(b) of Ind AS 2. Thus, the disclosure requirements of Schedule III to the Companies Act, 2013 are equally applicable to these items/products (classified as 'scrap' by the Company) as to the inventories of raw materials, finished goods, work-in-progress, etc.

Now, the Committee examines the issue raised by the Company relating to the disclosure of changes in the afore-mentioned inventory of 'scrap' used in the production process in the Statement of Profit and Loss. In this context, the Committee notes that Part II, 'Statement of Profit and Loss' under Division II of Schedule III to the Companies Act, 2013 requires the aggregate of the following expenses to be disclosed on the face of the Statement of Profit and Loss:

- Cost of materials consumed
- Purchases of Stock-in-Trade
- Changes in inventories of finished goods, work in progress and Stock-in-Trade
- Employee benefits expense
- Finance costs
- Depreciation and amortization expense
- Other expenses

The Committee further notes the following paragraphs of Guidance Note on Division II - Ind AS Schedule III to the Companies Act, 2013 (Revised January 2022 edition), issued by the ICAI (hereinafter referred to as 'the Guidance Note')

Expenses

The aggregate of the following expenses are to be disclosed on the face of the Statement of Profit and Loss:

- Cost of materials consumed
- Purchases of Stock-in-Trade
- Changes in inventories of finished goods, work in progress and stock in trade
- Employee benefits expense
- Finance costs
- Depreciation and amortisation expense
- Other expenses

Cost of materials consumed

This disclosure is applicable for manufacturing companies. Materials consumed would consist of raw materials, packing materials (where classified by the company as raw materials) and other materials such as purchased intermediates and components which are 'consumed' in the manufacturing activities of the company. Where packing materials are not classified as raw materials the consumption thereof should be disclosed separately. However, *intermediates and components which are internally manufactured are to be excluded from the classification.*

For purpose of classification of inventories, internally manufactured components may be disclosed as below:

- where such components are sold without further processing they are to be disclosed as 'finished products'.
- where such components are sold only after further processing, the better course is to disclose them as 'work-in-progress' but they may also be disclosed as 'manufactured components subject to further processing' or with such other suitable description as 'semi-finished products' or 'intermediate products'.
- where such components are sometimes sold without further processing and sometimes after further processing it is better to disclose them as 'manufactured components'."

"In the case of industries where there are several processes, materials may move from process to process, so that the finished product of one department constitutes the raw materials of the next. The consumption of raw materials for production of such intermediates would have to be accounted as raw materials consumed and so, it follows *that internal transfers from one department to another should be disregarded in determining the consumption figures to be disclosed."*

"9.5.3. Changes in inventories of finished goods, work-in-progress and stock-in-trade

This requires disclosure of the difference between opening and closing inventories of finished goods, work-in-progress and stock-in-trade. The difference should be disclosed separately for finished goods, work in progress and stock in trade."

The Committee notes from the requirements of Guidance Note in the context of disclosure of 'Expenses' in the Statement of Profit and Loss, as reproduced above, that 'materials consumed' would consist of materials, such as

purchased intermediates and components which are 'consumed' in the manufacturing activities of the company. The cost of intermediates or components which are internally manufactured and transferred from one department to another within the same entity should be excluded from the cost of materials consumed. Thus, only purchased and not internally manufactured and transferred intermediates can be included in the 'cost of materials consumed'.

Accordingly, the Committee is of the view that in the extant case, the inventories of intermediates or items/products, internally manufactured and transferred from one department to another within the Company should be considered as work-in-progress and presented under 'Changes in inventories of finished goods, work-in-progress and stock-in-trade' under 'Expenses' in the Statement of Profit and Loss as per the requirements of Schedule III to the Companies Act, 2013 with appropriate disclosures to explain the nature of inventory. Further, while presenting, the requirements of paragraph 9.5.1.1 of the Guidance Note should also be considered.

Opinion

On the basis of the above, the Committee is of the opinion that internally generated items/ products (classified as 'scrap'), used in the production process and transferred from one department to another within the Company should not be presented as 'cost of materials consumed'; rather should be considered as work-in-progress and presented under 'Changes in inventories of finished goods, work-in-progress and stock-in- trade' under 'Expenses' in the Statement of Profit and Loss as per the requirements of Schedule III to the Companies Act, 2013 with appropriate disclosures to explain the nature of inventory. Further, while presenting, the requirements of paragraph 9.5.1.1 of the Guidance Note should also be considered, as discussed above.

REGULATORY UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

SOCIAL AUDIT STANDARDS

ICAI has published sixteen Social Audit Standards (SASs), which correspond to the sixteen subject areas specified by SEBI and must be complied with by social auditors when it comes to impact reporting for social audit engagements. The SASs apply whenever an independent social audit of a social enterprise is carried out. Social enterprise may be a 'for profit' or 'not for profit' organisation. These standards lay out the minimal conditions that must be met, Additional requirements could be outlined in the form of laws or regulations that should be adhered to whenever they come into play. Following is the list of 16 SASs published by ICAI in the January 2023 edition:

- SAS 100: Eradicating hunger, poverty, malnutrition and inequality
- SAS 200: Promoting health care (including mental health) and sanitation; and making available safe drinking water
- SAS 300: Promoting education, employability and livelihoods
- SAS 400: Promoting gender equality, empowerment of Women and LGBTQIA+ communities
- SAS 500: Ensuring environmental sustainability, addressing climate change including mitigation and adaptation, forest and wildlife conservation
- SAS 600: Protection of national heritage, art and culture
- SAS 700: Training to promote rural sports, nationally recognised sports, Paralympic sports and Olympic sports
- SAS 800: Supporting incubators of social enterprises
- SAS 900: Supporting other platforms that strengthen the non-profit ecosystem in fundraising and capacity building
- SAS 1000: Promoting livelihoods for rural and urban poor including enhancing income of small and marginal farmers and workers in the non-farm sector
- SAS 1100: Slum area development, affordable housing, and other interventions to build sustainable and resilient cities
- SAS 1200: Disaster management, including relief, rehabilitation and reconstruction activities
- SAS 1300: Promotion of financial inclusion
- SAS 1400: Facilitating access to land and property assets for disadvantaged communities
- SAS 1500: Bridging the digital divide in internet and mobile phone access, addressing issues of misinformation and data protection
- SAS 1600: Promoting welfare of migrants and displaced

These Social Audit Standards will be applicable from the date of their hosting on ICAI website i.e. February 14, 2023.

TECHNICAL GUIDE ON DIGITAL ASSURANCE

ICAI has published Technical Guide on Digital Assurance in order to provide guidance to the members on the application of technology in auditing. It is a joint project of the Auditing and Assurance Standards Board (AASB) and the Digital Accounting and Assurance Board (DAAB). This Guide primarily focuses on sources of external audit evidence available and how it can be utilized by the members in their audit procedures. This Guide also highlights the importance of reliability and relevance of the source from which the information is being obtained.

Advancements in technology in recent years have improved accessibility and expanded the volume of information available to entities and their auditors from traditional to newer external sources/information. Traditional external sources of information, such as regulatory agencies and industry data providers, are increasingly making certain information more accessible. Changes in the entity's use of external information for financial reporting may, in turn, affect audits of the entity's financial statements and internal control over financial reporting.

The auditor must assess the relevance and credibility of external information presented as audit evidence, regardless of whether it was used by the entity (auditee) in compiling the financial statements or collected by the auditor.

The auditor's procedures regarding the reliability of information from external information sources may differ from procedures performed on information produced by the entity (IPE) because of the inherent limitations to evaluating the completeness and accuracy of information obtained from an external information source. An auditor may use digital information from external sources across various phases of the audit. Thus, audit evidence obtained from external sources plays a vital role in the audit process.

Audit of the future is data-driven and technology-enabled, thereby driving higher quality audits. This is possible only with multi-disciplinary and specialised talent within the audit team. A diverse audit team could consist of data scientists, engineers, and data analysts along with a team of Chartered accountants to enable a digital audit.

This technical guide also provides a few examples of how to use external electronic or digital data in audits.

STANDARD ON SUSTAINABILITY ASSURANCE ENGAGEMENTS (SSAE) 3000

The Sustainability Reporting Standards Board (SRSB) of ICAI has issued Standard on Sustainability Assurance Engagements (SSAE) 3000 which deals with assurance engagements on sustainability information of an entity.

The effective date of application of SSAE 3000 shall be as follows:

- Voluntary basis for assurance reports covering periods ending on 31 March 2023.
- Mandatory basis for assurance reports covering periods ending on or after 31 March 2024.

This standard notes that an assurance engagement may be either an attestation engagement or a direct reporting engagement. SSAE 3000 deals only with attestation engagements. Also, the standard deals with both these types of assurance engagements which may be either a reasonable assurance engagement or a limited assurance engagement.

In case there is subject matter information to which a specific assurance standard applies (e.g. GHG emissions), SSAE 3000 will apply in addition to the subject matter-specific standard (e.g. SAE 3410). The standard is similar to the "Framework for Assurance Engagements" issued by ICAI. However, in case of any conflicts between this standard and the Framework for Assurance Engagements, this Standard shall prevail.

It is critical that key decisions on the underlying subject matter and applicable criteria are established at the beginning of an assurance engagement and that these decisions are explicitly agreed upon and documented. Appropriate underlying subject matter should have two distinctive characteristics:

- It can be measured or evaluated against the criteria.
- It can be subjected to procedures to gather information required to support the necessary assurance conclusion (such as reasonable or limited assurance)

The execution of the standard includes Using the work of a practitioner's expert and work performed by another practitioner, a responsible party's or measurer's or evaluator's expert, or an internal auditor.

The assurance report shall be in writing and shall contain a clear expression of the practitioner's conclusion about the subject matter information. (Ref: Para. A2, A125–A127). The practitioner's conclusion shall be clearly separated from information or explanations that are not intended to affect the practitioner's conclusion, including any Emphasis on Matter, Other Matter, findings related to particular aspects of the engagements, recommendations or additional information included in the assurance report. The wording used shall make it clear that an Emphasis on Matter, Other Matter, findings, recommendations or additional information is not intended to detract from the practitioner's conclusion. (Ref: Para. A125–A127).

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

OPERATIONAL CIRCULAR FOR CREDIT RATING AGENCIES

The SEBI has issued Operational Circular for Credit Rating Agencies (CRA) dated 6 January 2023, in order to enable the industry and other users to have access to all the applicable circulars/ directions in one place. This Operational Circular is a compilation of the existing circulars as on 31 December 2022, with consequent changes.

The stipulations contained in these earlier circulars have been detailed chapter-wise in this operational circular as follows:

- Registration Requirements
- Rating Operations
- Reporting and Disclosures
- Internal Audit for CRAs
- Miscellaneous

SEBI has asked the CRAs, for a detailed policy by March-end in respect of the non-submission of crucial information, including quarterly financial numbers, by the issuers. Also, the detailed policy should contain methodology in respect of assessing the risk of non-availability of information from the issuers, including non-cooperative issuers and the steps to be taken under various scenarios in order to ascertain the status of non-cooperation by the issuer company.

Further, CRAs will have to follow a uniform practice of three consecutive months of non-submission of the no-default statement (NDS) as a ground for considering migrating the ratings to INC (issuers not cooperating) and need to tag such ratings within 7 days of three consecutive months of non-submission of NDS. The CRA in its judgement may migrate a rating to the INC category before the expiry of three consecutive months of non-receipt of NDS.

The provisions of the circular shall come into effect from 1 February 2023 and is applicable to all Registered Credit Rating Agencies, All Registered Debenture Trustees, Issuers who have listed and/or propose to list Non-Convertible Securities, Securitized Debt Instruments, Security Receipts, Municipal Debt Securities or Commercial Paper Recognized Stock Exchanges and all Depositories registered with SE.

PARTICIPATION OF AIFS IN CREDIT DEFAULT SWAPS

SEBI has issued a circular dated 12 January 2023, on the participation of alternative investment funds (AIFs) in Credit Default Swaps (CDS). Regulations 16(1)(aa),17(da), 18(ab)and 20(11) of SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations) enable AIFs to participate in CDS in terms of the conditions as may be specified by SEBI from time to time.

The circular has stated conditions applicable to Category I, II and III AIFs for buying CDS, conditions applicable to Category II and III AIFs for selling CDS and other conditions applicable for transacting in CDS including transacting and reporting by AIF in CDS transactions, which includes following:

- Category-I and Category-II AIFs can buy CDS on underlying investment in debt securities only for the purpose of hedging, while Category-III AIFs can purchase CDS for hedging or otherwise, within permissible leverage, the Securities and Exchange Board of India (Sebi) said in a circular.
- With regard to selling, Category-II and Category-III AIFs may sell CDS by earmarking unencumbered government bonds or Treasury bills equal to the amount of the CDS exposure. Such earmarked securities may also be used for maintaining applicable margin requirements for the CDS exposure.
- For Category II and Category III AIFs which sell CDS by earmarking securities, in case the amount of earmarked securities falls below CDS exposure, such AIFs will be required to send a report to the custodian on the same day of the breach.
- AIFs will have to report details of the CDS transaction to the custodian by the next working day.

INTRODUCTION OF FUTURE CONTRACTS ON CORPORATE BOND INDICES

SEBI has issued a circular dated 10 January 2023, to introduce future contracts on Corporate Bond Indices. In order to enhance liquidity in the bond market and also to provide an opportunity for investors to hedge their positions, it has been decided to permit Stock Exchanges to introduce derivative contracts on indices of corporate debt securities rated AA+ and above.

The stock exchanges desirous of introducing such contracts shall submit a detailed proposal to SEBI for approval, inter alia, providing details relating to the underlying corporate bond index, the index methodology, contract specifications, applicable trading, clearing & settlement mechanism, risk management framework, the safeguards to ensure market integrity, investor protection, surveillance systems, etc.

It has also laid down “Product design and risk management framework for Cash Settled Corporate Bond Index Futures (CBIF)”, which, among other things, include the following:

- The index should be composed of corporate debt securities, constituents of the index should have adequate liquidity and diversification at the issuer level and the constituents of the index should be periodically reviewed.
- Further, a single issuer should not have more than 15% weight in the index, there should be at least 8 issuers in the index, and the index should not have more than 25% weight in a particular group of issuers (excluding securities issued by public sector undertakings, public financial institutions and public sector banks).
- The trading hours should be between 9:00 AM and 5:00 PM on all working days from Monday to Friday.
- The daily settlement price shall be the volume-weighted average price of the last half an hour, while the final settlement price shall be the closing price of the underlying index on the expiry date.
- The final settlement price for the derivative contracts shall be the closing price of the underlying index on the expiry day or last trading day of such derivative contracts.

COMPREHENSIVE FRAMEWORK ON OFFER FOR SALE (OFS) OF SHARES THROUGH STOCK EXCHANGE MECHANISM

SEBI has issued a circular dated 10 January 2023, to modify certain provisions of the existing OFS framework through the Stock Exchange Mechanism. The comprehensive OFS framework has impacted the eligibility, cooling off period, size of OFS of share, advertisement and offering expenses and operational requirements, etc. Some of the significant highlights are summarised below:

Eligibility

- The facility of OFS of shares shall be available on the Bombay Stock Exchange (BSE), National Stock Exchange (NSE) and Metropolitan Stock Exchange of India (MSEI).
- All promoter(s) or promoter group entities of such companies that are eligible for trading and are required to increase public shareholding to meet the minimum public shareholding requirements in terms of Rule 19(2)(b) and 19A of Securities Contracts (Regulation) Rules, 1957 (SCRR), read with Regulation 38 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.
- OFS mechanism shall also be available to companies with a market capitalisation of INR 1,000cr and above. Any promoter or promoter group entity or non-promoter shareholder of such companies may offer shares through this mechanism.
- All investors registered with the brokers of the aforementioned stock exchanges other than the promoter(s) or promoter group entities shall be eligible to buy shares under OFS.
- In case the offer is by a non-promoter shareholder, the promoter(s) or promoter group entities may participate in the OFS, subject to compliance with various SEBI regulations.

Cooling off period

The cooling off period for a transaction (i.e. purchase or sale prior to and after the offer) in the shares of the company for the promoter(s) or promoter group entities and non-promoter shareholders for offering the shares through OFS mechanism shall be based on the liquidity of the shares on exchanges and are as under:

- For most liquid shares: +2 weeks
- For liquid shares: +4 weeks and
- For illiquid shares: +12 weeks

Order Placement

The Circular permits retail investors to bid in the unsubscribed portion of the non-retail segment. Prior to the Circular, while non-retail investors were allowed to bid for the unsubscribed portion of the retail segment, the vice versa position was not permitted. Consistent with former guidelines, retail investors are required to bid in the retail segment based on the cut-off price determined in the non-retail segment. However, in an event of under subscription in the non-retail segment, the retail investors can bid at the floor price and accordingly retail bids below the cut-off price or floor price, as applicable, shall be rejected.

Operational Requirements

- Appointment of a broker to undertake transactions on behalf of the eligible buyers.
- Sellers in OFS are required to announce intention of the sale of shares including floor price of the OFS to stock exchanges, latest by 5 PM on the day prior to the day of the OFS, through a notice of OFS. The Circular has introduced some flexibility wherein an extension up to 6 PM i.e. extension of one hour, can be granted by the stock exchanges on a case-to-case basis based on the seller's request, by recording reasons for such extension.
- The duration of the OFS shall be as per the trading hours of the secondary market.

SEBI has extended the option of divestment through the OFS Mechanism to listed InvITs and REITs, thereby allowing dilution of unitholding of these entities by the unit holders. The provisions of this Circular shall come into effect from the 30th day of issuance of this circular.

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY OF INDIA (IRDAI)

SUBMISSION OF REINSURANCE RETURNS

The IRDAI has issued a circular dated 3 January 2023, which has reference to the circular on submission of Reinsurance Returns and Programme vide ref no. IRDA/RI/CIR/MISC/011/01/2019 dated 15 January 2019. On comprehensively examining the extant returns being submitted, the following returns are hereby dispensed with immediate effect:

- Form 1.1: Summary of reinsurance treaties, submitted on yearly basis.
- Form LR-2: Particulars of Surplus Treaty, submitted on yearly basis.
- Form LR-4: Particulars of Quota Share Treaty, submitted on yearly basis.
- Form LR-6: Particulars of Excess of Loss cover/Catastrophe Treaty, submitted on yearly basis.
- Form LR-9: Data Uploading Format for Reinsurance Rate data, submitted on yearly basis.
- Statement 1: Statement of Reinsurance Statistics, submitted on a quarterly basis.
- Statement 2: Reinsurance Details- Inforce, submitted on yearly basis.
- Statement 3: Reinsurance Details- Withdrawn, submitted on yearly basis.

Life insurers are advised to continue filing the remaining returns in the existing formats to the reinsurance department till further instructions.

REGULATORY UPDATES

MINISTRY OF CORPORATE AFFAIRS (MCA)

NOTIFICATION DATED 19 JANUARY 2023: THE COMPANIES (INCORPORATION) AMENDMENT RULES, 2023 (AMENDED INCORPORATION RULES)

The Amended Incorporation Rules provide for the following:

- A subscriber to the memorandum must nominate some person as his/her nominee and such name must also be mentioned in the Memorandum of a One Person Company (OPC). These nomination details along with the consent must be filled in Form No. INC-32 which shall further be filed with the Registrar of Companies (RoC) at the time of incorporation of the Company.
- In case of withdrawal of such consent, as provided by a nominee, the sole member of OPC must nominate another person as nominee within 15 days of the receipt of the withdrawal notice and shall send an intimation along with the written consent of such other person so nominated in Form no-INC.4 (instead of Form INC-3 as provided currently).
- For conversion of OPC into a public company or a private company and private company to OPC, an application in e-Form No. INC-6 along with a modified list of documents [altered electronic -Memorandum of Association (MOA) and e-Articles of Association(AOA)] along with the prescribed fees must be filed with RoC and same shall be approved only upon examining the latest audited financial statement.
- In case of conversion of a company registered under section 8 into a company of any other kind, an intimation [along with a copy of the application filed with the Regional Director (RD)] must be filed with the RoC through the MCA system.
- In case of alteration of AOA, for effecting the conversion of a public company into a private company, the Service Request Number (SRN) of Form No. RD-1, pertaining to the order of the RD approving the alteration, shall be mentioned in Form No. INC-27 is to be filed with RoC with prescribed fees and documents, within 15 days from the date of receipt of the RD order.
- Process/documentation/forms related amendments pertaining to (i) conversion of unlimited liability company into a limited liability company by shares or guarantee (ii) shifting of registered office within same state (iii) shift of registered office from one state/union territory to another state (iv) application for change of financial year and many more.
- Substitution of various company forms like RUN, INC-4, INC-6, INC-9, INC-12, INC-13, INC-18, INC-20, INC-20A, INC-22, INC-23, INC-24, INC-27, INC-28, INC-31, INC-33, INC-34, INC-35, and RD-1.
- Omission of certain forms like INC-3 (One Person Company – Nominee Consent Form), INC-14 (Declaration), INC-15 (Declaration), RD-GNL-5 (filing addendum for rectification of defects or incompleteness).

NOTIFICATION DATED 20 JANUARY 2023: AMENDMENT TO THE COMPANIES (APPOINTMENT AND QUALIFICATION DIRECTORS) (AMENDMENT) RULES, 2023 (AMENDED DIRECTORS RULES)

The Amended Directors Rules provide that,

- upon receipt of notice/information about the disqualification of directors in Form DIR-8, the company must intimate the same to RoC in the prescribed form within 30 days of receipt of the same.

- An application for removal of disqualification of directors shall be filed with the RD in Form DIR-10.
- Further, various forms like Form DIR-3, DIR-3C, DIR-5, DIR-6, DIR-8, DIR-9, DIR-10, DIR-11 have been substituted.

NOTIFICATION DATED 20 JANUARY 2023: THE COMPANIES (PROSPECTUS AND ALLOTMENT OF SECURITIES) AMENDMENT RULES, 2023 (AMENDED ALLOTMENT RULES)

The Amended Allotment Rules provide for the following:

- The requirement of attaching a resolution passed in the general meeting authorizing the issue of bonus shares along with Form PAS-3 is done away with.
- Format of Form PAS-2 (Information Memorandum), PAS-3 (Return of Allotment) and PAS-6 (Reconciliation of Share Capital Audit Report (Half yearly) are substituted.

NOTIFICATION DATED 20 JANUARY 2023: THE COMPANIES (REGISTRATION OFFICES AND FEES) AMENDMENT RULES, 2023 (AMENDED REGISTRATION OFFICES RULES)

The Amended Allotment Rules provide for the following:

- A new provision has been inserted stating wherever applicable, e-forms shall be signed by the insolvency resolution professional or resolution professional or liquidator of companies under insolvency or liquidation and filed with the RoC along with the applicable fees.
- Format of Form GNL-2 (Form for submission of documents with the RoC), Form GNL-3 (Particulars of person(s) charged for the purpose of sub-clause (iii) or (iv) of clause 60 of section 2) and Form GNL-4 (Form for filing Addendum for rectification of defects or incompleteness) has been updated.

NOTIFICATION DATED 21 JANUARY 2023: THE COMPANIES (SHARE CAPITAL AND DEBENTURES) AMENDMENT RULES, 2023 (AMENDED SHARE CAPITAL & DEBENTURES RULES)

The Amended Share Capital & Debentures Rules provide for the following:

- Filling of certificate of compliance in respect of buy-back of securities in Form No. SH-15 is replaced with a simple declaration signed by two directors of the company, including the managing director, certifying compliance with the provisions of the buyback.
- Format of Form No. SH-7 (Notice to RoC of any alteration of share capital), Form No. SH-8 (Letter of Offer) and Form No. SH-9 (Declaration of Solvency) has been updated.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

NOTIFICATION DATED 2 JANUARY 2023: AMENDMENT TO THE SECURITIES CONTRACTS (REGULATION) RULES, 1957

Vide this notification, the relief from compliance of Rule 19A has been restricted only to Government Companies (as defined in this circular).

CIRCULARS DATED 5 JANUARY 2023: RELAXATION FROM COMPLIANCE WITH A CERTAIN PROVISION OF SEBI [LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS (LODR)] REGULATIONS, 2015

For the below-mentioned compliances, SEBI has relaxed/extended the date of compliance up to 30th September 2023:

- Requirement of sending a hard copy of the statement of an annual report to the shareholders not having their e-mail address registered with the company, subject to the below-mentioned conditions:
  - A hard copy of the statement of the annual report shall be sent upon specific request from any shareholder.
  - Notice of Annual General Meeting published by advertisement must have a link providing full access of the annual report to the shareholders.
- Requirement of sending proxy for annual general meetings held through electronic mode.
- Requirement of sending a hard copy of the statement of an annual report to the holders of non-convertible securities not having their e-mail address registered with the company or any depository.

NOTIFICATION DATED 9 JANUARY 2023: SEBI [ALTERNATIVE INVESTMENT FUNDS (AIF)] (AMENDMENT) REGULATIONS, 2023 (AMENDED AIF REGULATIONS)

Key highlights of the Amended AIF Regulations are as follows:

- The definition of 'credit default swaps' has been added which shall have the same meaning as defined in the Master Direction – RBI (Credit Derivatives) Directions, 2022.
- Category I AIFs are now allowed to engage in hedging, including credit default swaps, subject to conditions as may be specified by the SEBI from time to time.
- Category II and Category III AIFs are allowed to trade the credit default swaps subject to conditions as may be specified by SEBI from time to time.

- The extant framework provides that the Sponsor or Manager of the AIF having a corpus of more than INR 500 crores must appoint a registered custodian. However, in the case of the Sponsor or Manager of Category I and Category II AIF transacting in credit default swaps, the appointment of a registered custodian is a must for the safekeeping of the securities.

CIRCULAR DATED 12 JANUARY 2023: FACILITY OF CONDUCTING MEETINGS OF UNIT HOLDERS OF INFRASTRUCTURE INVESTMENT TRUSTS (INVIT) AND REAL ESTATE INVESTMENT TRUSTS (REITS) THROUGH VIDEO CONFERENCING (VC) OR OTHER AUDIO-VISUAL MEANS (OAVM)

As per the extant regulations, all unit holders of InvIT and REITs must meet at least once every year. To enable the maximum participation of unit holders in the meeting and for better governance, SEBI now provides a facility for participating in such meetings through VC or OAVM adopting the detailed procedure as provided in the circular.

Key points of the procedure are mentioned here:

- Manager to InvIT/REIT to maintain the recorded transcript of the meeting in its safe custody and shall be uploaded on the website of the InvIT / REIT.
- Managers to consider different time zones and the convenience of a different person while setting up a meeting.
- Two-way teleconferencing shall be allowed to ensure ease of participation in posing questions.
- The facility for joining the meeting shall be kept open for at least 15 minutes before and after such scheduled time.
- The facility for remote e-voting shall be provided before the meeting.
- At least one independent director of the Manager of the InvIT/REIT and the auditor of the InvIT/REIT or his/her authorised representative who is qualified to be the auditor shall attend such meeting.
- Notice for such meeting (with prescribed disclosures) shall be provided to unitholders at their registered email address.
- The Manager is to disclose about such online meetings in advance to the stock exchange and trustee.

NOTIFICATION DATED 17 JANUARY 2023: SEBI (CHANGE IN CONTROL IN INTERMEDIARIES) (AMENDMENT) REGULATIONS, 2023 (THE AMENDED REGULATIONS)

SEBI, vide this notification published the Amendment Regulations to further amend:

- SEBI (Debenture Trustees) Regulations), 1993 modifying the definition of 'Change in control' to mean that:
  - change in control in case of a body corporate (where the shares are listed) shall be construed with reference to the definition of control provided in the SEBI Act, 1992.
  - change in control in case of a body corporate (where shares are not listed) shall be construed with reference to the definition of control provided in the Companies Act, 2013.
- SEBI (AIFs) Regulations, 2012 modifying the definition of 'Change on control' to mean:
- **In case of body corporates:**
  - where the shares are listed, the meaning shall be construed with reference to the definition of control provided in the SEBI Act, 1992.
  - where shares are not listed, the meaning shall be construed with reference to the definition of control provided in the Companies Act, 2013
- **In a case other than that of a body corporate:**
  - change in control shall be construed as any change in its legal formation or ownership or change in controlling interest (any direct or indirect interest of at least 50% of voting rights or interest)

NOTIFICATION DATED 17 JANUARY 2023: SEBI (LODR) (AMENDMENT) REGULATIONS, 2023 (AMENDED LODR REGULATIONS)

Key highlights of the Amended LODR Regulations are as follows:

- Certain specified provisions related to corporate governance pertaining to the Chapter 'Obligations of a listed entity which has listed its specified securities and Non-Convertible Debt Securities' shall not be applicable to a 'high-value debt listed entity' i.e. a REIT or InvIT (applicable w.e.f. 1 April 2023)
- The definition of "senior management" has been inserted to mean and include the officers and personnel who are members of the core management team and all the members of the management one level below the Chief Executive Officer or Managing Director or Whole Time Director or Manager including the functional heads, the Company Secretary and the Chief Financial Officer of the company.
- A public sector company must take shareholders' approval for the appointment/re-appointment of a person on the Board of Directors or as a manager in the upcoming general meeting.
- Details of material subsidiaries of the listed entity, the date & place of incorporation and the name/date of appointment of the statutory auditors of such subsidiaries shall be disclosed in the annual report (applicable for Annual Reports filed for the financial year 2022-2023 and thereafter).

RESERVE BANK OF INDIA (RBI)

CIRCULAR DATED 4 JANUARY 2023: FOREIGN INVESTMENT IN INDIA - RATIONALISATION OF REPORTING IN SINGLE MASTER FORM (SMF) ON FOREIGN INVESTMENT REPORTING AND MANAGEMENT SYSTEM (FIRMS) PORTAL

The Circular, inter alia, provides for the following changes which are being implemented with respect to the reporting of foreign investment in SMF on the FIRMS portal.

- The forms submitted on the portal will be auto-acknowledged and to be verified by the Authorised Dealer (AD) Bank within 5 working days of such upload of documents.
- In cases of delay in reporting, the AD banks shall either advise the Late Submission Fee (LSF) to the applicants or for compounding of contravention.

The circular also provides for a detailed/stepwise process to be followed upon submission of forms in FIRMS.

MASTER DIRECTION DATED 16 JANUARY 2023: RBI (ACQUISITION AND HOLDING OF SHARES OR VOTING RIGHTS IN BANKING COMPANIES) DIRECTIONS, 2023 (THE DIRECTIONS):

The Directions which shall apply to all banking companies including Small Finance Banks (SFBs) and Payments Banks (PBs) operating in India, inter-alia, provide for the following:

- Any person who intends to acquire a major shareholding in a banking company shall do so with the prior approval of RBI and in relation to such approval, the RBI may seek comments from the banking company. For this purpose, the banking company shall adopt a board-approved 'fit and proper criteria' for its major shareholders at all times.
- Post the acquisition, if at any time the aggregate holding of the major shareholder drops below 5% of the paid-up share capital, such person shall be required to seek fresh approval from the RBI if he/she intends to raise his/her shareholding to 5% or more of the paid-up share capital of the banking company. Further, persons from FATF non-compliant countries are not permitted to acquire a major shareholding in any Indian banking company.
- From the regulatory perspective, the Directions mandate banking companies to:
  - continuously monitor that the specified persons are fulfilling the 'fit and proper' criteria on an ongoing basis.
  - Put in place a mechanism to obtain information on a continuous basis regarding any development on the 'fit and proper' status of shareholders/applicants.
  - Make an assessment report about the 'fit and proper' test and forward the same with the board's comments to the RBI within the prescribed due date.
- The banking company shall also obtain information of a change in significant beneficial ownership or transfer of 10% or more of the paid-up equity share capital by a major shareholder. Such changes shall be reported to the RBI along with the board resolution in this regard within the prescribed time.
- Other requirements specified by the directions include submission of diluted shareholding plan by the banking companies whose shareholding structure is not in conformity with the RBI Guidelines, reporting of allotment of shares, details of encumbrance of shares by promotor(s) to RBI in prescribed forms within the prescribed time.

NOTIFICATION DATED 23 JANUARY 2023: FULLY ACCESSIBLE ROUTE FOR INVESTMENT BY NON-RESIDENTS IN GOVERNMENT SECURITIES – INCLUSION OF SOVEREIGN GREEN BONDS

RBI, vide this notification, designates all Sovereign Green Bonds issued by the Government in the fiscal year 2022-23 as 'specified securities' under a Fully Accessible Route wherein non-resident investors can invest in certain specified categories of central government securities without any restrictions.

DIRECT TAX

CIRCULARS / NOTIFICATIONS / PRESS RELEASE

TIME-LIMIT TO CLAIM AN EXEMPTION UNDER SECTIONS 54 TO 54GB OF THE IT ACT EXTENDED

The Central Board of Direct Taxes (CBDT) owing to the COVID-19 pandemic had provided relaxation in respect of certain compliances to be made by taxpayers vide Circular no. 12 of 2021 dated 25 June 2021[1]. Such compliances include, inter alia, investment, deposit, payment, acquisition, purchase, construction or such other action, by whatever name called, for purpose of claiming exemption under section 54 to 54GB of the Income-tax Act, 1961 (IT Act). As per the said circular, the last date for aforementioned compliances falling between 1 April 2021 and 29 September (both days inclusive) was extended to 30 September 2021. In view of the representations received and considering the then-prevailing COVID-19 pandemic and related restrictions, the CBDT has recently issued a circular providing that the last date for aforementioned compliances falling between 1 April 2021 and 28 February 2022 (both days inclusive) shall be extended to 31 March 2023.

[Circular No. 1/2023, dated 6 January 2023]

UNION BUDGET 2023

At a time when the country's economy faces challenges from a host of global factors, rising inflation, and a possible GDP growth slowdown in FY24, the Hon'ble Finance Minister Ms. Nirmala Sitharaman presented the last full budget of the Modi 2.0 government, ahead of the next year's parliamentary elections. Largely appreciated as a progressive Budget in contrast to the general populous expectations, it outlines 7 priorities- - Inclusive development, Reaching the last mile, Infrastructure and investment, Unleashing the potential, Green growth, Youth power and the Financial sector. To read BDO India's analysis of the Budget 2023, please go to: https://www.bdo.in/en-gb/insights/publications/india-union-budget-2023-24_an-overview-a-bdo-india-publication

JUDICIAL UPDATES

SUPREME COURT HOLDS SPECIAL AUDIT ORDER UNDER SECTION 142(2A) INVALID IF NOT DULY COMMUNICATED TO THE TAXPAYER

Taxpayer, a university set up by the State of Madhya Pradesh, had filed a writ petition against the order passed by Madhya Pradesh High Court challenging the notice issued by the chartered Accountant for undertaking a special audit for Fiscal Year 2017-18 under section 142(2A)[2] of the IT Act. In the case of the taxpayer, it was never served with any order under section 142(2A) of the IT Act. However, Madhya High Court overlooked this fact on the ground that the order need not be passed and only a hearing is required. Aggrieved, the taxpayer preferred an appeal before the Supreme Court which based on the following observations held that an order needs to be passed and communicated to the taxpayer:

- The learned Solicitor General accepts that the order under section 142(2A) of the IT Act was never communicated or even uploaded on the portal. However, the written order was placed in the order sheet file.
- The order is required to be communicated to the taxpayer to know the reasons and if required, choose to exercise the fundamental option to challenge the order.

[1] Refer BDO alert- https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-further-extends-deadline-of-certain-compliances-en

[2] As per section 142(2A) of the IT Act, the tax officer, at any stage of the assessment, having regard to specific circumstances and with prior approval of designated authority, direct the taxpayer to get the accounts audited by a nominated Chartered Accountant. Such specific circumstances can be the nature, complexity, volume of the accounts, doubts about its correctness, multiplicity of transactions in the accounts or specialised nature of business activity of the taxpayer and the interests of the revenue.

- The assessment order has not been passed and has become time-barred. There is ambiguity about whether the special audit has been filed before the tax officer and even if is filed, the special audit report would be of no use as no assessment order can now be passed.
- It is directed that with respect to the purported order, a special audit under section 142(2A) of the IT Act will not be given effect to and will be treated as not passed since it was never communicated to the taxpayer. Further, the time limit for passing the assessment order was extended till 31 December 2023.
- If the tax officer desires a special audit under section 142(2A) of the IT Act, he can either rely upon the earlier notice or issue a fresh notice. In case earlier notice has been referred, it should be indicated and communicated to the taxpayer.
- After hearing as per law, an order under section 142(2A) of the IT Act if passed, should be communicated to the taxpayer. If any special audit is ordered to be conducted, the date 31 December 2023 will get extended as per the provision of the IT Act.

  [Rajiv Gandhi Proudyogiki Vishwavidyalaya v/s Union of India and Others, Civil Appeal No. 1904 of 2022 (Supreme Court)]

SERVICE PROVIDER ELIGIBLE FOR DTAA BENEFIT ON FEES FOR TECHNICAL SERVICE, ABSENT BACK-TO-BACK ARRANGEMENT WITH HOLDING COMPANY

Taxpayer, a US-based Company, is rendering branding and management services to its associate Indian entity. For the relevant year under consideration, the taxpayer offered the service income to tax at 15% (gross basis) as fees for included services in terms of Article 12 of the India-USA Double Tax Avoidance Agreement (DTAA). However, the tax officer denied the DTAA benefit and sought to tax the receipts at 25% (gross basis) on the ground that the taxpayer had a back-to-back agreement of passing the fee received to its holding company. Accordingly, the tax officer held the taxpayer as merely a recipient and not the beneficial owner of said fees entitled to DTAA benefit. Aggrieved, the taxpayer filed an appeal before the First-Appellate Authority which based on the explanation provided by the taxpayer and email communication between group entities concluded that there is no back-to-back arrangement and ruled in favour of the taxpayer. Aggrieved, tax authorities filed an appeal before the Delhi Tax Tribunal which held in favour of the taxpayer. Further aggrieved, tax authorities filed an appeal before the Delhi High Court which upheld the order of the Delhi Tax Tribunal and made the following observations:

- The First-Appellate Authority has touched upon two important aspects. First, there was no back-to-back arrangement between the taxpayer and its holding company. Second, in order to deny the status of a beneficial owner, the tax office had to find that the taxpayer was either an agent or conduit for the holding company.
- The Taxpayer was playing the role of a service provider after procuring the same from other group companies and it had dominion and control over the fees received by it.
- The Taxpayer is entitled to the status of the beneficial owner once it is held that there was no back-to-back arrangement and it had dominion and control over the fees received. Thus, the taxpayer is entitled to DTAA benefits under Article 12 of the India-USA DTAA.

  [CIT-International Taxation-1 v/s Fujitsa America Inc., ITA No. 530/2022 (Delhi High Court)]

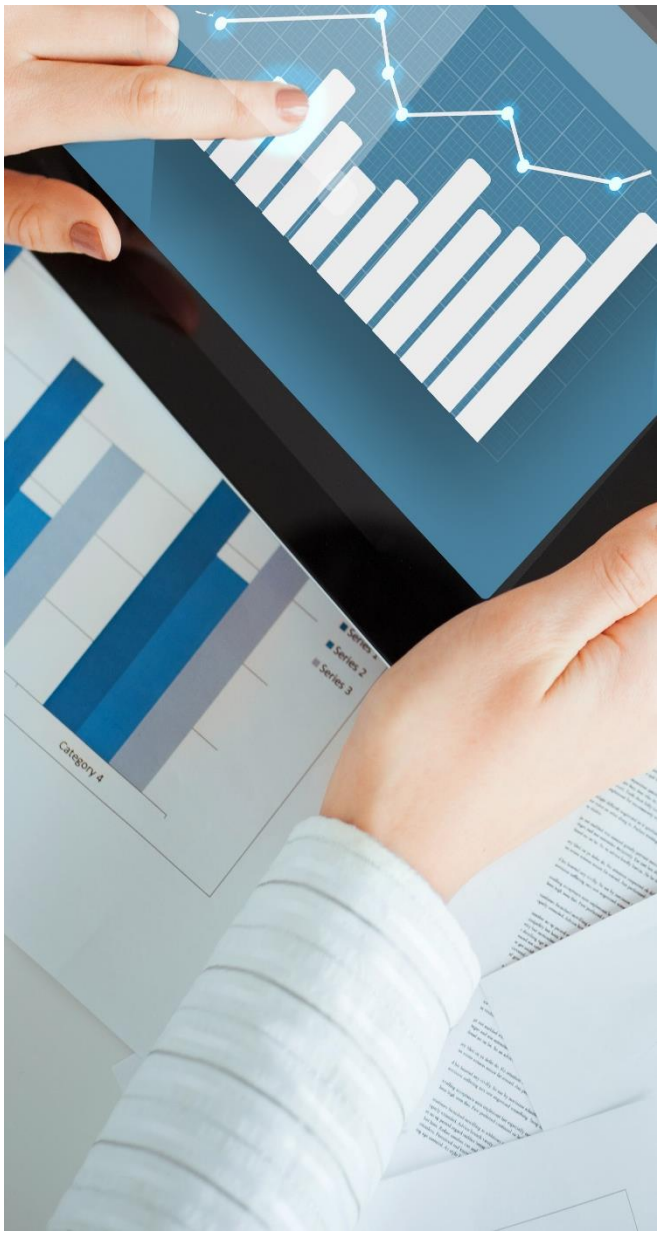
MANAGEMENT SUPPORT SERVICES NOT TAXABLE AS FEES FOR TECHNICAL SERVICES (FTS) UNDER INDIA-BELGIUM DTAA BY INVOKING MOST FAVOURED NATION (MFN) CLAUSE

Taxpayer, a Belgian entity, provides management support services such as administration, management, marketing and sale of the company's product and other services to its Indian subsidiary. At the time of filing its India tax return, the taxpayer claimed management support services as not taxable in India. During assessment proceedings, the taxpayer submitted that as per Article 12(3)(b) of the India-Belgium DTAA, Fees for Technical Services (FTS) includes payment received for services of managerial, technical or consultancy nature and chargeable to tax at 10%. However, it can be reduced on account of the MFN clause as per clause (i) of the protocol to India-Belgium DTAA. As per the protocol, if India enters into a DTAA after 01 January 1990 with a third state being an OECD member whereby India limits its taxation in respect of royalty or FTS to a lower rate or more restricted scope than India-Belgium DTAA, then such lower rate or restricted scope shall also apply under the India-Belgium DTAA. The Taxpayer submitted that as per India-UK DTAA, the term FTS has been defined to mean consideration received for the rendering of any technical or consultancy services and specifically excludes managerial services. Accordingly, India-UK DTAA being more restricted will apply to India-Belgium DTAA as per the MFN clause. The tax officer rejected the contention of the taxpayer and held that the amount is taxable as FTS under section 9(1)(vii) of the IT Act as well as India-Belgium DTAA

r.w. India-UK DTAA thereby applies the rate of 15% on a gross basis. Aggrieved, the taxpayer filed an appeal before the First-Appellate Authority who after observing the Master Service Agreement MSA) allocated 50% of the receipts for consultancy services i.e. FTS. Further aggrieved, the taxpayer filed an appeal before the Delhi Tax Tribunal which held in favour of the taxpayer and made the following observations:

- As per Article 12(3)(b) of India-Belgium DTAA, FTS includes any payment received towards managerial, technical or consultancy services and is chargeable to tax at 10% in the source country. However, clause (i) of the protocol to India-Belgium DTAA provides for the MFN clause. Further, the taxpayer's contention pertaining to the applicability of India-UK DTAA is duly accepted by the tax authorities. Therefore, it has to be seen what the scope is and meaning of FTS under India-UK DTAA.
- As per the scope of services under the MSA, a taxpayer shall provide assistance to the Indian subsidiary in the administration, management, marketing and sale of the company's products and services including but not limited to business planning, product management, business development, market and manufacturing strategy, logistics and distribution planning, personnel and human resources management.
- The Taxpayer i.e. supplier shall have no power or authority to conclude or accept contracts on behalf of the customer while rendering services.
- Indian subsidiary i.e. service recipient shall maintain the confidentiality of all confidential or proprietary information or data of the supplier including technical specifications, technological data and price information, list of customers and proposals made to or receive from third-party customers. Such proprietary material shall at all times remains the property of the supplier and on termination of the MSA, the customer shall immediately deliver to the supplier written documentation including copies, of such proprietary materials and make no further use of it.
- The scope of services to be rendered under the MSA does not indicate that they are anything other than managerial services as it aids and assists the customer for performing its day-to-day business activity.
- Once the taxpayer was able to demonstrate that the amount received is in the nature of managerial services, it cannot be treated as FTS in view of the restrictive meaning of FTS under Article 13(4) of the India-UK DTAA, which specifically excludes managerial services.
- Assuming a part of the services provided by the taxpayer are in the nature of consultancy services (as held by the First-Appellate Authority), the same does not satisfy the make available condition, as it does not amount to imparting of technical knowledge, skill, knowhow etc. by service recipient independently as per Article 13(4) of India-UK DTAA.

[Wolters Kluwer Financial Services v/s. DCIT, ITA No. 8267/Del/2019 (Delhi Tribunal)]



GOODS & SERVICES TAX (GST)

JUDICIAL UPDATES

WRIT PETITION

SHOW CAUSE NOTICE CANNOT BE ADJUDICATED AFTER AN INORDINATE DELAY OF 11 YEARS

Facts of the case

- M/s. CMA-CGM Agencies (India) Pvt Ltd (Taxpayer) is a service provider supplying various services such as Steamer Agent service, Cargo Handling Services, Business Support Services, GTA and Business Auxiliary Services.
- Pursuant to the audit for FY 2004-05 to FY 2007-08, the Taxpayer's Delhi office was served with a show cause cum demand notice on 12 October 2009 (SCN).
- Subsequently, the Taxpayer filed a reply, denying the allegations made in the impugned notice.
- Pending adjudication, effective 9 September 2010, the Taxpayer had obtained a centralised Service tax registration in respect of its offices across India.
- After a span of 11 years from the date of issuance of SCN, a personal hearing was scheduled before the Commissioner, CGST and Central Excise, Navi Mumbai on 24 September 2020.
- The Taxpayer challenged the aforesaid action of the Tax Authority seeking to adjudicate the SCN before the Hon'ble Bombay High Court.

Contention of the Taxpayer

- The Taxpayer submitted that upon grant of centralised Service tax registration, the Divisional Officer was obliged to intimate the respective jurisdictional Service Tax officer to transfer the relevant records to its office. However, the files pertaining to the aforesaid SCN were not transferred;
- Thereafter, the Tax Authority neither took any steps to transfer the said files nor sought to adjudicate the SCN.
- The Taxpayer submitted that the notice of personal hearing was issued 11 years after the issuance of the said SCN and failure to adjudicate despite the inordinate delay has rendered the proceedings ex-facie invalid, illegal, untenable and unsustainable in law.
- The Taxpayer relied on the following decisions wherein, in similar cases due to an inordinate delay in adjudication of a show cause notice, the Hon'ble High Court held that the delay to be unreasonable, set aside the proceedings and has allowed the Petitions:
  - **Parle International Ltd. vs. Union of India [2021 (375) ELT 633 (Bom.)]**
  - **Sushitex Exports (India) Ltd. vs. Union of India [2022 (380) ELT 244 (Bom.)]**

Contention of the Tax Authorities

- The Tax Authority submitted that the adjudication files relating to the Taxpayer were received on 24 January 2019.
- It was further submitted that, although the Tax Authority had tried multiple times for conducting a personal hearing, the Taxpayer had not attended any personal hearing, and therefore, the adjudication of the order is pending till date.

Observations and Ruling by the High Court

- The Hon'ble High Court observed that the Tax Authorities had delayed the transfer of proceedings from Delhi to Mumbai without any satisfactory explanation.
- Relying on the principle laid down in Parle International Ltd. (supra), it was observed that the proceedings should be concluded within a reasonable time and proceedings that are not concluded within a reasonable time (which the Court on the facts of each case has to consider), may not be allowed to proceed further.
- It was also held that while the Tax Authority's right in law to initiate proceedings for violation of the provisions of the Act can never be disputed, at the same time, they do not have the unfettered right to choose a time to conclude the said proceeding as per their own whims and fancies.
- Accordingly, it was concluded that the present proceedings ought to have been concluded within a reasonable time and any attempt to adjudicate the same now after an inordinate and unreasonable lapse of time would be detrimental and cause severe prejudice to the Taxpayer.
- In view of the above, the Hon'ble Bombay High Court quashed the said SCN and allowed the Writ Petition.

  [High Court of Bombay, M/s. CMA-CGM Agencies (INDIA) Pvt Ltd Vs UOI,2023-VIL-32-BOM-ST dated 17 January 2023]

JUDICIAL UPDATES-EXCISE/SERVICE TAX/CUSTOMS

REFUND OF SERVICE TAX PAID ON BOOKING OF FLATS IS AVAILABLE IN CASE OF CANCELLATION OF SUCH BOOKING

Facts of the case

- M/s. Credence Property Developers Pvt Ltd (Taxpayer) is engaged in providing services by way of the construction of residential complexes on which applicable taxes were discharged.
- Upon booking, the Taxpayer had collected applicable taxes from the buyer and subsequently, deposited the same to the Government Exchequer. However, in case of cancellation of such booking(s), the Taxpayer refunded the advance amount paid (along with applicable Service Tax) by the buyer.
- The Taxpayer had filed two refund claims under Section 11B of the Central Excise Act, 1944 read with Section 83, Finance Act, 1994 amounting to INR 109,367 and INR 55,123 respectively seeking a refund of Service Tax paid in respect of two flats which were initially booked by a buyer but were subsequently cancelled.
- The Adjudicating Authority vide Order-in-Original, rejected the refund claim. Further, the appeal filed by the Taxpayer before the Commissioner (Appeals) against the aforesaid order was rejected.

Contentions by the Tax Authorities

- Refund of Service Tax would not arise since the Taxpayer has not paid any excess Service Tax but has only paid the tax which they were liable to pay in respect of the services provided;
- In respect of the present situation, there is no provision for a refund of Service Tax.

Contentions by the Taxpayer

- Cancellation of booking of flats is considered as non-provision of service as specified by Rule 6(3) of Service Tax Rules, 1994.
- Under the GST regime, there is no mechanism to claim such credits in the GST returns, and therefore, the only remedy available to the Taxpayer is to claim a refund of excess Service Tax paid.
- Cancellation of the booking coupled with the fact of refunding the booking amount (along with taxes) would mean as if no service was provided by the Taxpayer.
- Absent such provision of service, the Taxpayer cannot be saddled with any Service tax liability, and the amount deposited by the Taxpayer with the Government Exchequer will be considered as a 'deposit'.
- Any attempt of the Tax Authority to retain such amounts would be violative of Article 265 of Constitution of India. Hence, the Taxpayer is entitled to claim such a refund.

Observations and Ruling by the CESTAT

- CESTAT observed that if a service has been provided that is taxable under the Finance Act, of 1994, Taxpayer is liable to pay Service tax. However, when no such service has been provided, the Taxpayer cannot be saddled with any tax liability, and the amount deposited will be treated as a 'deposit'. Any attempt to retain such a deposit is violative of Article 265 of the Constitution of India.
- In the present case, it can be concluded that no service has been provided by the Appellant as the service contract got terminated and the consideration for service has been returned.
- Accordingly, CESTAT has concluded that Tax Authorities are incorrect in their view that mere cancellation of the booking of flats does not mean that there was no service and that the Taxpayer is entitled to a refund.

  [CESTAT-Mumbai, M/s. Credence Property Developers Pvt Ltd Vs C.C.E.-Mumbai 2023-VIL-53-CESTAT-MUM-ST dated 5 January 2023]

TAXPAYER ENTITLED TO INTEREST ON DELAYED REFUND FROM THE ORIGINAL DATE OF REFUND APPLICATION

Facts of the case

- M/s. Bombardier Transportation India Private Limited (Taxpayer) had initially filed the refund application on 13 June 2011 which was rejected by the sanctioning authority, and the matter travelled up to the CESTAT.
- CESTAT vide order No. A/12474/2021 dated 07 October 2021 allowed the appeal of the Taxpayer.
- Subsequently, the sanctioning authority has granted the refund, without interest.
- The aforesaid action of disallowing interest was challenged before the Commissioner (Appeals) which had rejected the same on the ground that the Taxpayer has claimed a refund pursuant to the CESTAT and therefore, the refund was sanctioned within three months from that date. Consequently, the eligibility to claim interest on delayed payment of refund would not arise.

Contentions by the Taxpayer

- The Taxpayer submitted that it is settled law that the interest shall be payable after three months from the date of filing of refund application. Therefore, the Taxpayer is legally entitled for the interest after the expiry of three months from the date of filing the refund claim, which, in the present case is 13 June 2011.
- In this regard, the Taxpayer placed reliance on the principle laid down by the Hon'ble Supreme Court in M/s. Ranbaxy Laboratory Ltd. [2011 (273) ELT 3 (SC)].

Observations and Ruling by the CESTAT

- CESTAT, after examining the provision of Section 11BB of the Central Excise Act,1944 observed that the Commissioner (Appeals) has gravely erred in misinterpreting the provision.
- The provision of Section 11BB of the Central Excise Act, 1944 states that the claimant shall be entitled for the interest after the expiry of three months from the date of refund application.
- In the present case, the refund application was admittedly filed on 13 June 2011 and the case was under litigation up to the CESTAT, and subsequently, the Taxpayer succeeded in claiming the refund. Therefore, the date of the refund application which was filed on 13 June 2011 shall be treated as a refund application mentioned under Section 11BB.
- CESTAT held that the Taxpayer is legally entitled for the interest on the refund. Accordingly, the impugned order is set aside and the appeal is allowed.

  [CESTAT-Ahmedabad, Bombardier Transportation India Pvt Ltd Vs. C.C.E. & S.T.-Vadodara-II Order No:A/10191/2023, 1 February 2023]

TRANSFER PRICING

AMP EXPENSE IS NOT AN INTERNATIONAL TRANSACTION

The taxpayer is engaged in the manufacturing and sales of 'toys' in India. The taxpayer incurred expenses towards advertising, marketing and promotion (AMP) during the year for its own business.

The Transfer Pricing Officer (TPO) was of the view that the AMP expenses resulted in the creation of marketing intangibles benefitting the Associated Enterprise (AE) and thus fell under the purview of international transactions. Accordingly, the TPO applied the Bright Line test (BLT) and made an adjustment towards the 'excess' AMP expenses of the taxpayer.

On further appeal by the taxpayer, the Commissioner of Income-tax, Appeals (CIT(A)) deleted the entire adjustment since the profit margin of the taxpayer was greater than that of comparable companies. In this regard, the Revenue Dept preferred an appeal before the Hon'ble Tribunal.

Similar to the previous years, the taxpayer contended that incurring AMP expenditure does not fall within the definition of an international transaction as there is no mutual agreement or arrangement for allocation or apportionment of any cost or expenses incurred. The taxpayer also contended that a distinction is required to be drawn between function and transaction, as every expenditure forming part of function cannot be construed as a transaction.

In light of the above and consistent with the previous years' decisions, the Hon'ble Tribunal ruled that AMP expenditure in not an international transaction.

DCIT Vs. Mattel Toys (India) Pvt. Ltd. [TS-911-ITAT-2022(Mum)-TP]

INTEREST ON RECEIVABLES @LIBOR + 200 BPS AND CREDIT PERIOD OF 120 DAYS

The taxpayer is engaged in the business of legal process outsourcing services. The TPO made an adjustment towards interest on outstanding receivables from its AE. The TPO adopted the Comparable Uncontrolled Price (CUP) method and benchmarked the transaction with the short-term interest rate charged by the State Bank of India. Further, the TPO did not set off the trade payables against the receivables before making the adjustment.

On further appeal, the CIT(A) placed reliance on the jurisdictional Tribunal's decision in the case of OSI Systems Pvt. Ltd. and re-computed the adjustment by charging interest at the rate of LIBOR + 200 basis points. However, the CIT(A) did not follow the aforesaid Ruling while deciding the credit period and arbitrarily decided on a credit period of 60 days.

The Hon'ble Tribunal placed reliance on the co-ordinate bench Ruling of Altisource Business Solutions (P) Ltd. and held that that non-charging or undercharging of interest on the excess period of credit allowed to the AE for the realization of invoices, amounts to an international transaction and the Arm's Length Price (ALP) of such an international transaction is required to be determined.

Further, the Hon'ble Tribunal placed reliance on the decision in the case of OSI Systems Pvt. Ltd. and held that the export turnover is required to be received in foreign exchange, hence interest on outstanding receivables should be considered at LIBOR + 200 bps instead of rates charged by banks/NBFCs. Further, continuing to place reliance on the aforementioned Ruling, Hon'ble Tribunal decided that a period of 120 days seemed like a reasonable credit period.

ACIT Vs. Quislex Legal Services P Ltd [TS-918-ITAT-2022(HYD)-TP]

NO AMP ADJUSTMENT WHEN TPO ACCEPTS GROSS AND NET MARGINS OF THE ASSESSEE

The taxpayer is engaged in trading of input and output imaging devices like printers and projectors. The taxpayer determined the arm's length nature of its distribution segment under the Resale Price Method (RPM) and corroborated the same under Transactional Net Margin Method (TNMM). Further, the AMP expenses incurred by the taxpayer were included in the cost base while computing the margins under TNMM.

The TPO made an adjustment towards the AMP expenses incurred by the taxpayer by treating it as a separate international transaction. However, the TPO did not reject the RPM and TNMM analysis carried out by the taxpayer while doing so. Further, the Dispute Resolution Panel (DRP) upheld the adjustment made by the TPO.

The Hon'ble Tribunal relied on the Delhi High Court's decision in the case of Sony Ericsson Mobile Communication India Private Limited and Tribunal decisions in the taxpayer's case for the previous years and held that the AMP cannot be treated as a separate international transaction, once the TPO has accepted the gross margin and net margin of the taxpayer.

DCIT Vs. Epson India Private Limited [TS-902-ITAT-2022(Bang)-TP]

DETERMINING THE ALP OF PURCHASE OF COMMERCIAL RIGHTS AND DEPRECIATION THEREON

The taxpayer (WNS Global Services Private Limited) is engaged in the business of providing information technology-enabled business process outsourcing servicing, including data processing and transmission of data.

WNS Capital Investment Private Limited (WCIL), a Group entity of WNS group, entered into a Master Services Agreement (MSA) with Aviva Global Services (Aviva Singapore) in 2008. WCIL had outsourced work under the MSA to various group entities across India (including the taxpayer) and Sri Lanka under a revenue-sharing arrangement with an 85% share of aforesaid group entities and 15% of WCIL.

In 2009, as part of the restructuring of the WNS group, the Indian group entities providing services to Aviva Singapore under the MSA were merged into the taxpayer.

In 2011, the taxpayer purchased all rights and obligations of the MSA from WCIL for USD 110mn. The consideration was based on a valuation report from a third-party valuation expert, who undertook the valuation based on 'expected earnings from MSA for the balance unexpired period and the expected growth in the revenue from Aviva Singapore'.

The TPO made an adjustment by computing the consideration that the taxpayer should have paid WCIL as follows:

- Replacing the 'projected revenue' with the actual billings, since he believed that the taxpayer had substantially overvalued the projections, which have rendered the valuation report as unreliable; and
- By adopting the incremental approach, since the revenues were already being shared by the taxpayer and WCIL in an 85:15 ratio under the original arrangement

Further, the DRP agreed with the view of TPO and upheld the adjustment.

Based on various Rulings by the Delhi High Court and co-ordinate Benches of the Tribunal, the Hon'ble Tribunal deleted the entire TP adjustment by observing the following:

- the DRP/TPO had not adopted any Transfer Pricing method as specified in Section 92C of the Income-tax Act, 1961, to determine the arm's length price.
- the DRP/TPO did not find any fault in the steps/methodology adopted for valuation by the taxpayer.
- the DRP/TPO undertook an ad-hoc valuation without appointing a valuation expert.
- the valuation report obtained by the taxpayer can be considered as external CUP in absence of any contrary certificate.
- the valuation has to be done on the basis of certain parameters or forecasts made at the point of valuation and considering the conditions existing at the time of decision-making since any future happenings/occurrence cannot be foreseen.

In addition, the Assessing Officer (AO) made an adjustment towards the depreciation of the said rights, claiming that the commercial rights do not fall under the definition of intangible assets under Section 32(1) of the Act.

The Hon'ble Tribunal on basis of an identical issue in case of the taxpayer in a previous year ruled that the commercial rights purchased fall within the definition of intangible assets as per Section 32(1)(ii) read with Explanation 3(b) of the Act and the depreciation on the said intangible is allowed deduction.

DCIT Vs. WNS Global Service Private Limited [TS-1273-ITAT-2020(Mum)-TP]

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