ACCOUNTING, REGULATORY & TAX NEWSLETTER

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INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA ("ICAI")

EAC Opinion – Estimation of Final Mine Closure Plan and treatment of the same in the books of account on year-on-year basis.

Facts of the case

A Company is a Government of Karnataka undertaking Company, incorporated under the Companies Act, 1956 and is having its registered office at Bangalore. The Company is engaged in scientific and eco-friendly exploration and marketing of various minerals in the state of Karnataka. There are number of working/ non-working/ surrendered/ cancelled mines/quarries leases held by the Company.

The Company has stated that as per the provisions of 'Indian Bureau of Mines and Mineral Conservation and Development Rules (MCDR), 2017', the holder of a mining lease shall submit a Final Mine Closure Plan (FMCP) to the competent authority for approval, two years prior to the proposed closure of the mine.

The Company has further stated that if the Company wants to submit the plan and make provision in the last two financial years before the closure of the lease of mines/quarries, the expected expense will be so huge that it will have huge impact on profits and will affect fair presentation as the expenditure that will be booked, pertain to several years.

As a prudent accounting practice, it requires that the Company shall estimate and account for the estimated cost of Final Mine Closure Plan (FMCP) and spread the same across the life of the mine/ quarry for presentation of financial statements as per the applicable financial reporting framework and to give true and fair view.

As the Company is involved in mining activities, it needs to follow the Rules laid down by Indian Bureau of Mines. Accordingly, the management has decided to provide for the liability of FMCP and amortise it over the remaining leasehold period.

The Company has reproduced paragraphs 45 to 47 of Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' as follows:

"45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

46 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted.

The brief description of accounting practices followed by the Company along with the facts and figures is listed below:

- In the year 1: The Company estimates the Final Mine Closure Plan. This is usually done by the concerned technical department, in the year one, based on the current scheduled rate prepared by the Public Works Department, Government of Karnataka. The amount so arrived will be converted into present value using the discounting factor @7.5% and amortised over the lease period of the mine/quarry.
- In the year 2:
  - The present value of the Final Mine Closure Plan will be arrived for the year 2,
  - The difference between the present value of the year 2 and present value arrived for the year 1 will be treated as 'Interest/Finance Cost'.
- The detailed worksheet computed for the financial year (F.Y.) 2018-19 is furnished for a better understanding, which is briefly summarized as follows:

Particulars	Amount (INR in lakhs)
Final Mine Closure Plan arrived during the year 2017-18	24,383.46
Present Value of Final Mine Closure Plan for the year 2017-18	8,627.29
Present Value of Final Mine Closure Plan for the year 2018-19	9,274.34
Difference of PV of FMCP of 2018-19 and 2017-18 is treated as interest charge/finance cost	647
Amortization charged to Asset (Present Value of FMCP for year 2017-18 divided by life of the mines calculated for each individual mine)	833.74

Audit observation by the Indian Audit and Accounts department:

- The Indian Audit and Accounts Department (Comptroller & Auditor General (C&AG)), which conducts the supplementary audit of the annual accounts of the Company in accordance with the provisions of the Companies Act, 2013, is not in agreement with the accounting policy followed by the Company, and they are of the view that the Final Mine Closure Plan estimated by the Company is based on the current scheduled rates and as such, the need for discounting does not arise and hence present value of Final Mine Closure Plan should be Rs. 24,383.46 Lakhs and not 8,627.29 Lakhs.
- The Company in its reply to the audit observation, has given assurance to the C&AG that the matter will be referred to the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India (ICAI)

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and will take the expert advice to follow the suitable accounting policies consistently.

The Company has separately informed that the estimate of Final Mine Closure Plan for the period 2017-18 is the expenditure to be incurred towards closure activities at the end of mine life, which is considered as per the current scheduled rate of the Public Works Department, Government of Karnataka.

Query

On the basis of the above, the Company has sought the opinion of the Expert Advisory Committee on the following issues

- Whether the accounting practices followed by the Company is in accordance with the Generally Accepted Accounting Principles or not.
- Whether the audit observation made by the C & AG is valid or not.
- Whether there is any best practice to be followed by the Company in respect of Mine Closure obligation.

Points considered by the Committee

The Committee notes that the basic issue raised by the Company relates to accounting for Mine Closure obligation by the Company under Indian Accounting Standards (Ind ASs), notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time. The Committee has, therefore, restricted the opinion only to this issue and has not examined any other issue that may arise from the Facts of the Case.

At the outset, the Committee notes the nature of expenditure incurred under Final Mine Closure Plan from the following definitions under 'Mineral Conservation and Development Rules, 2017':

"(a) "abandonment of mine" means the final closure of a mine, either whole or part thereof, when the mineral deposits within the mine or part thereof have been fully extracted or when the mining operations thereon have become uneconomic;"

"(m)"final mine closure plan" means a plan for the purpose of decommissioning, reclamation and rehabilitation of a mine or part thereof after cessation of mining and mineral processing operations, that has been prepared in the manner specified in the standard format and guidelines issued by the Indian Bureau of Mines or the Director, Atomic Minerals Directorate for Exploration and Research in respect of minerals specified in Part B of the First Schedule to the Act where the grade of such atomic minerals is equal to or above the threshold value limits declared under Schedule-A of the Atomic Minerals Concession Rules, 2016;

(n) "final mine closure" means steps taken for reclamation and rehabilitation of a mine or part thereof commencing from cessation of mining or processing operations in a mine or part thereof;"

The Committee notes from the Facts of the Case that the Company has stated that as per the provisions of 'Indian Bureau of Mines and Mineral Conservation and Development Rules (MCDR), 2017', the holder of a mining lease shall submit to the competent authority for approval, two years prior to the proposed closure of the mine, a Final Mine Closure Plan (FMCP) which means a plan for the purpose of decommissioning, reclamation and rehabilitation of a mine or part thereof after cessation of mining and mineral processing operations. Thus, there is a legal obligation for the Company in the extant case to incur decommissioning, reclamation and rehabilitation expenditure due to mining operations or extraction activities of the Company.

The Committee notes that Ind AS 106, 'Exploration for and Evaluation of Mineral Resources', states the following

"5 An entity shall not apply this Ind AS to expenditures incurred:

- before the exploration for and evaluation of mineral resources, such as expenditures incurred before the entity has obtained the legal rights to explore a specific area.
- after the technical feasibility and commercial viability of extracting a mineral resource are demonstrable.

"101 Expenditures related to the development of mineral resources shall not be recognised as exploration and evaluation assets. The Conceptual Framework for Financial Reporting under Indian Accounting Standards issued by the Institute of Chartered Accountants of India and Ind AS 38, Intangible Assets, provide guidance on the recognition of assets arising from development."

"11 In accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources."

"15 An entity shall classify exploration and evaluation assets as tangible or intangible according to the nature of the assets acquired and apply the classification consistently.

Some exploration and evaluation assets are treated as intangible (eg drilling rights), whereas others are tangible (eg vehicles and drilling rigs). To the extent that

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a tangible asset is consumed in developing an intangible asset, the amount reflecting that consumption is part of the cost of the intangible asset. However, using a tangible asset to develop an intangible asset does not change a tangible asset into an intangible asset.

The Committee notes that Ind AS 106 provides that obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources are governed by the requirements of Ind AS 37. Further, as per the Standard, exploration and evaluation assets are treated as property, plant and equipment or intangible assets according to the nature of assets; and the expenditure related to development of resources shall also be governed by the Conceptual Framework and Ind AS 38.

The Committee now notes that Ind AS 16, 'Property, Plant and Equipment' contains following guidance for initial measurement of an item of property, plant and equipment:

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

- Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
- Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
- The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period."

Similarly, Ind AS 38, 'Intangible Assets' also contains the following guidance for initial measurement of a separately acquired intangible asset:

"27 The cost of a separately acquired intangible asset comprises:

- Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
- Any directly attributable cost of preparing the asset for its intended use."

The Committee notes from the above that both Ind AS 16 and Ind AS 38 require costs that are directly attributable to acquire the asset or to bring the asset to the location and condition necessary for it to be capable of operating in the intended manner to be included in the initial measurement. Further, Ind AS 16 specifically provides that the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period (for purposes other than to produce inventories during that period) shall be included in the cost of an item of property, plant and equipment.

The Committee further notes the requirements of Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' as follows:

"14 A provision shall be recognised when:

- **An entity has a present obligation (legal or constructive) as a result of a past event;**
- **It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and**
- **A reliable estimate can be made of the amount of the obligation. If these conditions are not met, no provision shall be recognised."**

"19 It is only those obligations arising from past events existing independently of an entity's future actions (i.e. the future conduct of its business) that are recognised as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage, both of which would lead to an outflow of resources embodying economic benefits in settlement regardless of the future actions of the entity. Similarly, an entity recognises a provision for the decommissioning costs of an oil installation or a nuclear power station to the extent that the entity is obliged to rectify damage already caused. In contrast, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised."

"36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

37 The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an obligation at the end of the reporting period. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the end of the reporting period."

"42 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

43 Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgements under conditions of uncertainty, so that income or assets

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are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.

44 Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 85(b).

Present value

45 Where the effect of the time value of money is material, the amount of a provision shall be the present value of the expenditures expected to be required to settle the obligation.

46 Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting period are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.

47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted."

"60 Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognised as borrowing cost."

In this regard, Committee also notes following paragraphs of Guidance Note on Accounting for Oil and Gas Producing Activities (for entities to whom Ind AS is applicable) although the Guidance Note may not be strictly applicable for mineral resources other than oil and gas:

"Accounting for Abandonment Costs

33. Abandonment costs are the costs incurred on discontinuation of all operations and surrendering the property back to the owner. These costs relate to plugging and abandoning of wells; dismantling of wellheads; production; and transport facilities and to restoration of producing areas in accordance with license requirements and the relevant legislation.

34. In accordance with Ind AS 37, Provisions, Contingent Liabilities and Contingent Assets, an entity recognises any obligations for removal and restoration that are incurred during a particular period as a consequence of having undertaken the exploration for and evaluation of mineral resources. Thus, an entity should capitalise as part of property, plant and equipment or intangible asset, as the case may be, the amount of provision required to be created for subsequent abandonment. The provision for estimated abandonment costs should be made at current prices considering the environment and social obligations, terms of mining lease agreement, industry practice, etc. Where the effect of the time value of money is material, the amount of the provision should be the present value of the expenditures expected to be required to settle the obligation. The discount rate (or rates) should be a pre-tax rate (or rates) that reflect current market assessments of the time value of money and the risks specific to the liability. The discount rate should not reflect risks for which future cash flow estimates have been adjusted. … However, the change in the estimated provision due to the periodic unwinding of the discount should be recognized in statement of profit and loss as it occurs. Since abandonment costs do not reflect borrowed funds, the unwinding cost would not be a borrowing cost eligible for capitalization."

As discussed above, the Committee notes that the Company is under a legal obligation to incur costs on site restoration and mine closure work as per its governing laws. Under Ind AS 37, a provision is required to be recognised in respect of such costs since there exists an obligation to perform the site restoration and closure of the mine. However, the relevant regulations should be taken into account when determining the existence and extent of the obligation. Thus, the Company in the extant case should recognise a decommissioning or restoration provision in respect of the mine closure obligation and this obligation may arise even before any production takes place. The Committee further notes that the accounting for decommissioning provision will depend on how the related costs have been accounted for. If the related costs are capitalised, the associated decommissioning costs should also be capitalised and included in the initial measurement of the related tangible or intangible asset. However, if the related costs are expensed (such as certain exploration and evaluation costs that do not meet the capitalisation criteria under Ind AS 106), any associated decommissioning or restoration costs should also be expensed.

With regard to measurement of the provision, the Standard provides that the provision shall be recognised at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the end of the reporting period. Thus, the Committee is of the view that the provision for estimated expenditure should

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be made at current prices at the reporting date considering the relevant conditions and obligation. Further, since the mine closure costs are towards the closure activities at the end of the mine life, the obligation is a long-term obligation and therefore, if the effect of time value of money is material, the provision should be discounted. Accordingly, the initial cost of the related asset should include the present value of the expenditure expected to be required to settle the obligation. Thus, although the estimates are made at current prices on the reporting date, since the estimates are for the expenditure to be incurred in the future at the end of mine life, these are discounted if the effect of time value of money is material.

Subsequently, where discounting is used, the carrying amount of a provision is increased in each period to reflect the passage of time. This increase is recognised as borrowing cost. Further, the cost of the related asset, including the initial estimate of mine closure costs, should be depreciated/amortised based on the pattern in which the related asset's future economic benefits are expected to be consumed in accordance with the requirements of the relevant Standards.

Opinion

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

(i), (ii) & (iii)The Company should follow the accounting for mine closure obligation, as detailed above. The appropriateness of the accounting practices followed by the Company in accordance with the generally accepted accounting principles and validity of C&AG observations would depend on the above-mentioned accounting.

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SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Securities and Exchange Board of India (Collective Investment Schemes) (Amendment) Regulations, 2022

The SEBI vide notification dated May 10, 2022 has brought amendments to the Securities and Exchange Board of India (Collective Investment Schemes) Regulations, 1999 to strengthen the regulatory framework for collective investment schemes (CIS) and to empower the Collective Investment Management Companies (CIMCs) to properly discharge their responsibilities towards their investors. Some of the significant amendments are as follows:

- Enhancement of the net worth criteria and track record requirements for entities managing collective investment schemes (CIS). Applicants or promoters of CIS should have a soundtrack record in all their business transactions.
- Minimum 20 investors and a subscription amount of at least Rs. 20 crores is mandated by SEBI for each CIS. At present, there are no rules regarding a minimum number of investors or minimum subscription amount.
- SEBI also capped cross-shareholding in Collective Investment Management Company (CIMC) to 10% to avoid conflict of interest.
- CIMCs should have a minimum net worth of Rs. 50 crores. At present, the net worth requirement is Rs. 5 crores.

Circular dated 13th May 2022: Relaxation from compliance with certain provision of SEBI (Listing Obligations and Disclosure Requirements) (“LODR”) Regulations, 2015

Various relaxations provided vide this circular are as follows and the same shall be applicable with immediate effect:

- A waiver from sending a hard copy of the statement of Annual Report to the shareholders not having their e-mail address registered with the company up to 31st December 2022. However, the hard copy must be sent upon specific request from any shareholder.
- Notice of AGM published by advertisement must have a link providing full access of annual report to the shareholders.
- For general meetings held through electronic mode, the requirement to send proxy forms has been waived up to 31st December 2022.

Circular dated 18th May 2022: Simplification of procedure and standardization of formats of documents for transmission of securities

SEBI vide its previous notification dated 25th April 2022, had simplified the procedure for transmission of securities.

Pursuant to this circular, SEBI inter alia, specifies the followings in relation to transmission of securities which shall be applicable with immediate effect.

- A list of the documents required for transmission of securities, in case of demise of the sole holder as per Annexure – A of this Circular.
- The Operational Guidelines for processing investor’s service request for the purpose of transmission of securities as per Annexure – B of the Circular.
- A format of the form to be filed by nominee/claimant/legal heir while requesting transmission of securities as per Annexure – C of this Circular.
- Various other process related steps/forms/formats are given in Annexure D to G of this circular.

The RTAs/listed issuers/depositories must strictly adhere to the formats and documentation specified through this Circular for all transmission matters including requirement of Will.

Circular dated 25th May 2022: Simplification of procedure and standardization of formats of documents for issuance of duplicate securities certificates

SEBI, vide this notification, has simplified the procedure for issuance of duplicate securities & its documentation requirements which shall come into force with immediate effect.

Key highlights of the circular are as under:

- Security holder to submit copy of First Information Report (FIR) including e-FIR/Police complaint/Court injunction order/copy of plaint having specified details.
- Security holder to issue advertisement regarding loss of securities
- Submission of Affidavit and Indemnity bond as per the format prescribed by the Board.
- In case, the value of securities as on the date of submission of application is up to INR 5 Lacs, the requirement mentioned in point 2 & 3 above shall not be applicable.
- The applicant to quantify the value of the securities based on the closing price of such securities, a day prior to the date of such submission in the application.
- An overseas securities holder to provide self-declaration of the security certificates lost/misplaced/stolen which shall be duly notarized/apostilled/attested by the Indian Consulate/Embassy in their country of residence.

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- Fake/forged/stolen certificates or certificates must be seized and defaced by the listed company / RTA and disposed of in the prescribed manner.
- A listed company shall take special contingency insurance policy to safeguard and protect its interest.

This circular also provides for detailed operational guidelines for processing investor's service request and detailed list of documents required to be submitted by security holder while requesting for issuance of duplicate securities.

Circular dated 30th May 2022: Standard Operating Procedures ("SOP") for disputes between a listed company and/or Registrar to an Issue and Share Transfer Agents (RTAs) and its shareholders

Regulation 40 of SEBI (LODR) Regulations, 2015 provides for a dispute resolution under the Stock Exchange Arbitration Mechanism for disputes between a listed company and its shareholders.

In this regard, a SOP for operationalizing the resolution of all disputes pertaining to various investor services such as transfer/transmission/dematerialization/rematerialization/ duplicate issue of shares, transposition of holders, dividend, bonus, rights entitlements, credit of securities in public issue, interest payments on securities etc. is now put in place which shall be effective from 1st June 2022.

The SOP shall be applicable to Listed Companies or RTAs offering services on behalf of listed companies where claims or disputes arise between the shareholder(s)/ investor(s) of listed companies and the RTAs, the RTAs shall be subjected to the stock exchange arbitration mechanism.

The circular further provides the detailed arbitration procedure, appellate arbitration, fees and place of arbitration, hearing, disclosures etc.

MINISTRY OF CORPORATE AFFAIRS (MCA)

Notification dated 5 May 2022: Companies (Prospectus and Allotment of Securities) Amendment Rules, 2022 ("Amended Rules")

The Amended Rules provide that a company shall not make offer or invitation of securities to a body corporate incorporated in, or a national of a country, sharing a land border with India unless prior approval of Government of India under the FEMA (Non-debt Instruments) Rules, 2019 is taken and same is attached with private placement offer cum application letter ("PAS-4").

Further, the Amended Rules also provide for revised format of PAS-4, including a necessary declaration from the applicant.

Various Circulars: Relaxations granted by MCA through various circulars:

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

MCA permits companies to conduct their AGM, which were due to be held in the year 2022, on or before 31st December 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 permits companies to conduct their Extraordinary General Meeting through VC or OAVM or transact items through postal ballot subject to certain conditions till 31st December 2022.

Relaxation on levy of additional fees in filing of certain e-forms by Limited Liability Partnerships ("LLPs")

MCA allows LLPs to file:

- various event-based forms (due date of which are falling between 25th February 2022 to 31st May 2022) without paying additional fees, up to 30th June 2022.
- Annual return in e-Form 11 for the Financial Year ("FY") 2021-2022 without paying additional fees, up to 30th June 2022.

Notification dated 30th May 2022: Companies (Compromises, Arrangements and Amalgamations) Amendment Rules, 2022 ("Amended Rules")

The Amended Rules provide that in case of any compromise/arrangement involving merger or demerger between an Indian company and a company incorporated in a country which shares land border with India is required to submit a declaration in Form No. CAA-16 at the time of making an application with National Company Law Tribunal ("NCLT"), confirming whether a prior approval is required to be obtained under the Foreign Exchange Management (Non-Debt Instruments) Rules, 2019.

Notification dated 31st May 2022: Companies (Accounts) Third Amendment Rules, 2022 ("Amended Rules")

MCA vide its previous notification dated 11th February 2022 had introduced Form CSR-2 which had to be filed for the preceding FY i.e., 2020-21, on or before 31st March 2022, after filing Form AOC-4. The due date was later extended to 31st May 2022.

Vide this notification, the due date is further extended to 30th June 2022.

Further, the notification also provides that for FY 2021-2022, Form CSR-2 shall be filed separately on or before 31st March 2023 after filing Form AOC-4 or AOC-4 XBRL or AOC-4 NBFC (Ind AS), as the case may be.

THE RESERVE BANK OF INDIA (RBI)

Maintenance of Cash Reserve Ratio (CRR)

The RBI vide notification dated May 04, 2022 has increased the Cash Reserve Ratio (CRR) of all banks by 50 basis points from 4.00 percent to 4.50 percent of their Net Demand and Time Liabilities (NDTL) as announced in the Governor's Statement dated May 04, 2022. The said notification is effective from the reporting fortnight beginning May 21, 2022.

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Reserve Bank of India (Financial Statements - Presentation and Disclosures) Directions, 2021 - Reporting of reverse repos with Reserve Bank on the bank's balance sheet

The RBI vide circular dated May 19, 2022, has brought following clarifications on the presentation of reverse repos on the balance sheet of the Banks:

- All type of reverse repos with the Reserve Bank including those under Liquidity Adjustment Facility shall be presented under sub-item (ii) 'In Other Accounts' of item (II) 'Balances with Reserve Bank of India' under Schedule 6 'Cash and balances with Reserve Bank of India'.
- Reverse repos with banks and other institutions having original tenors up to and inclusive of 14 days shall be classified under item (ii) 'Money at call and short notice' under Schedule 7 'Balances with banks and money at call and short notice'.
- Reverse repos with banks and other institutions having original tenors more than 14 days shall be classified under Schedule 9 – 'Advances' under the following heads:
  - (ii) 'Cash credits, overdrafts and loans repayable on demand'
  - (i) 'Secured by tangible assets'
  - (I).(iii) Banks (iv) 'Others' (as the case may be)

This circular is applicable to all the Commercial Banks.

Notification dated 2nd May 2022: Minimum Investment Grade Credit Ratings for Deposits of Non-Banking Financial Companies ("NBFCs")

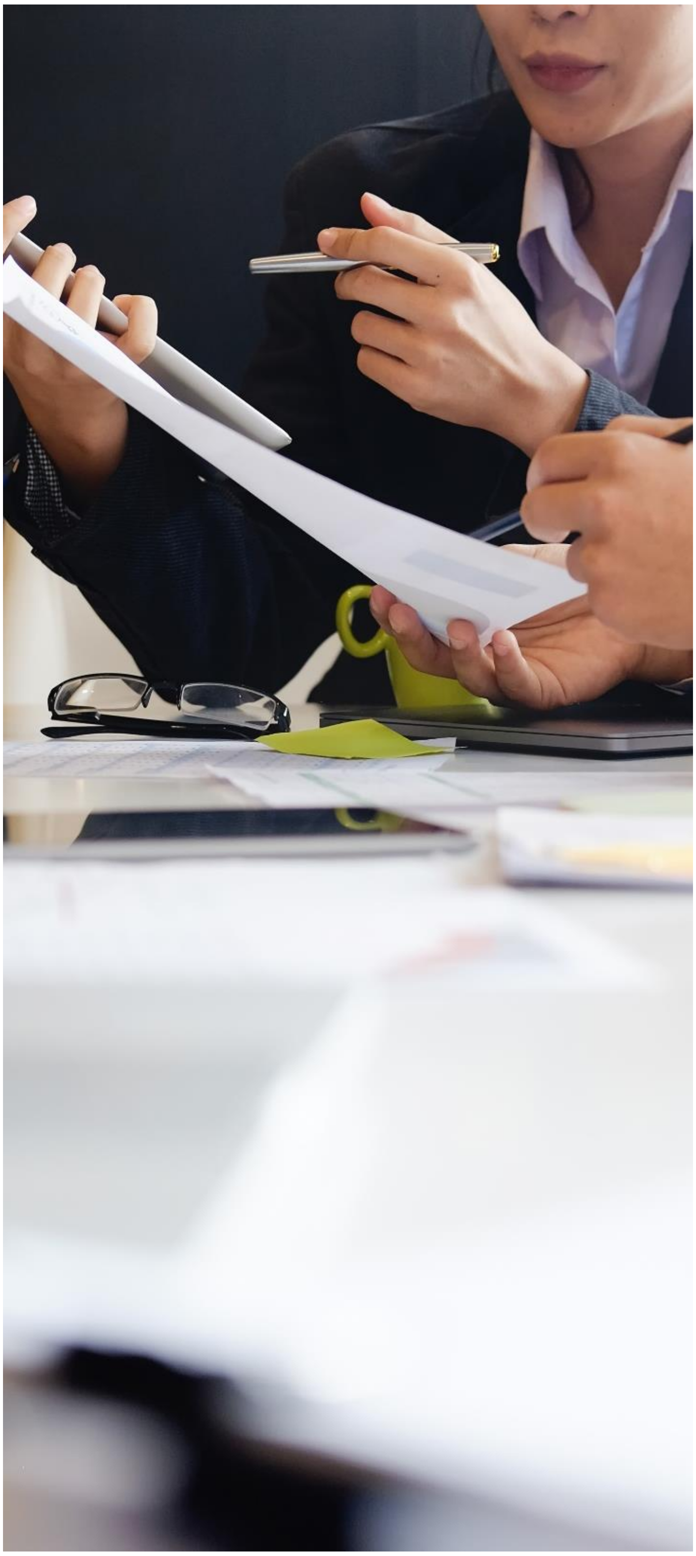
As per the extant framework, NBFCs with net owned funds of INR 25 Lacs and above need to obtain a minimum investment grade or other specified credit ratings from any one of the approved credit rating agencies at least once a year, to accept public deposits.

RBI vide this notification has decided the minimum investment grade credit rating for deposits of NBFCs to be '**BBB-**' from any of the SEBI-registered Credit Rating Agencies.

INSOLVENCY AND BANKRUPTCY BOARD OF INDIA

Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2022

The IBBI vide notification dated April 28, 2022 amended the Insolvency and Bankruptcy Board of India (Liquidation Process) Regulations, 2016 by including the explanation after regulation 2A 'Contributions to liquidation costs', 21A 'Presumption of security interest' and 31A 'Stakeholders' consultation committee' that the requirements of this regulation shall apply to the liquidation processes commencing on or after the date of the commencement of the Insolvency and Bankruptcy Board of India (Liquidation Process) (Amendment) Regulations, 2019."



TAX UPDATES
Direct Tax

CIRCULARS/ NOTIFICATIONS/PRESS RELEASE

CBDT issues guidelines for compulsory selection of returns for complete scrutiny during Fiscal Year 2022-23

Every year, the Central Board of Direct Taxes (CBDT) notifies the parameters and procedure for compulsory selection of returns for complete scrutiny. For Fiscal Year (FY) 2022-23, these parameters are:

- Cases pertaining to survey under section 133A of the Income-tax Act, 1961 (IT Act) subject to below exclusions:
  - Books of accounts, documents, etc. were not impounded;
  - Returned income (excluding any disclosure of hitherto undisclosed income made during the Survey) is not less than returned income of preceding year; and
  - Taxpayer has not retracted from the disclosure referred to in point (ii) above
- Cases pertaining to Search and Seizure – Scrutiny to be made under section(s) 153A, 153C read with section 143(3) of the IT Act and also for tax return filed for the year relevant to FY in which the Search was conducted under section 132 of the IT Act or requisition was made under section 132A of the IT Act;
- Cases where no return has been furnished in response to a notice under section 142(1) of the IT Act;
- Cases where return is either furnished or not furnished in response to notice under section 148[1] of the IT Act;
- Cases where registration / approval under various sections of the IT Act, such as section 12A, 35(l)(ii) / (iia) / (iii), 10(23C), etc. have not been granted or have been cancelled / withdrawn by the Competent Authority, yet the taxpayer has been found to be claiming tax-exemption / deduction in the tax return. However, where such orders of withdrawal of registration / approval have been reversed / set-aside in appellate proceedings, those cases will not be selected under this clause.
- Cases involving addition in earlier year(s) on a recurring issue of law or fact and / or law and fact (including transfer pricing issue) is:
  - exceeding INR 2.5 mn in eight metro charges at Ahmedabad, Bengaluru, Chennai, Delhi, Hyderabad, Kolkata, Mumbai and Pune;
  - exceeding INR 1 mn in charges other than eight metro charges;

  and where such addition:

  - has become final as no further appeal has been preferred against the order; or
  - has been upheld by the Appellate Authorities in favor of Tax Authorities; even if further appeal of taxpayer is pending
- Cases related to specific information regarding tax-evasion where:
  - specific information pointing out tax-evasion for the relevant year is provided by any law-enforcement agency (Investigation Wing/ Intelligence/ Regulatory Authority/ Agency, etc.); and
  - the return for the relevant year is furnished by the taxpayer.

The Circular also clarifies that where return has been furnished in response to notice under section 142(1) of the Act and such notice was issued due to the information contained in NMS Cycle / SFT information / information received from Directorate of I&CI, such return will not be taken up for compulsory scrutiny but through CASS cycle.

[Circular F. NO. 225/81/2022/ITA-II, dated 11 May 2022]

CBDT notifies procedure for filing appeal against Board for Advance Rulings

As per section 245W of the IT Act, if the applicant or tax officer is aggrieved by any ruling pronounced / order passed by the Board for Advance Rulings, then they may file an appeal before the High Court against such ruling or order of the Board for Advance Rulings within 60 days of the communication of that ruling or order, in such Form and manner, as may be prescribed.

In this regard, the CBDT has notified Rule 44FA to provide the Form and manner of filing an appeal before the High Court. The Rule states that the Form and manner will be the same as provided in the applicable procedure laid down by the jurisdictional High Court for filing an appeal to the High Court.

[Notification No. 57/2022 dated 31 May 2022]

[1] Reassessment

TAX UPDATES
Direct Tax

CBDT issues Instruction for implementation of Supreme Court pronouncement on validity of reassessment notices

On 4 May 2022, the Supreme Court in the case of UOI vs. Ashish Aggarwal has held that the reassessment notices issued as per the old procedure shall be deemed to be issued as per the new procedure and has directed tax officers to follow the new procedure with respect to such notices. It has also directed that the decision shall be applicable to all similar matters pending before any Authority and shall be deemed to have been adjudicated accordingly. To give effect to this judgement, the CBDT has issued a detailed Instruction for the tax officer that may be taken into consideration while implementing this judgement. To read our detailed analysis, please go to : https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-issues-instruction-for-implementation-of-supreme-court-pronouncement-on-vali

[CBDT Instruction No. 1/2022, dated 11 May 2022]

CBDT amends Faceless Penalty Scheme

CBDT had notified Faceless Penalty Scheme, 2021 to provide modalities for undertaking penalty proceedings in a faceless manner. Recently, the CBDT has amended this Scheme by notifying Faceless Penalty (Amendment) Scheme, 2022. To read our detailed analysis, please go to : https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-amends-faceless-penalty-scheme

[CBDT Notification No.: 55/2022/F. No. 370142/51/2020-TPL(Part III), dated 27 May 2022]

CBDT updates 'Compliance Check functionality' for section 206AB and section 206CCA

The Finance Act 2021 inserted section 206AB and section 206CCA in the IT Act to provide for higher tax withholding in respect of certain specified persons. Subsequently, the CBDT issued a circular providing for a 'Compliance Check' functionality that can be used by person who is withholding taxes to check whether deductee / collectee comes within specified person or not. The Finance Act, 2022 has made amendments in the definition of specified person for both these provisions. In view of these amendments, recently, the CBDT has issued another circular to incorporate these amendments by updating the earlier Compliance Check functionality. To read our detailed analysis, please go to:

https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-updates compliance-check-functionality%E2%80%99-for-section-206ab-and-section-206cc

[Circular No. 10/2022, dated 17 May 2022]

Obtaining and quoting of PAN mandatory for certain transactions

Section 139A(1) of the IT Act provides for instances where a taxpayer is mandatorily required to obtain Permanent Account Number (PAN). This section also grants power to the CBDT to notify additional transactions where the person is required to obtain PAN and quote it while undertaking such specified transactions. Further, as per Section 139A(6A) of the IT Act, any person entering into prescribed transactions are required to quote their PAN or Aadhar number and ensure that the same is authenticated. Recently, the CBDT has notified transactions where PAN is to be obtained by person entering into such transactions. To read our detailed analysis, please go to : https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-obtaining-and-quoting-of-pan-mandatory-for-certain-transactions

[CBDT Notification No. 53/2022 dated 10 May 2022]

JUDICIAL UPDATES

Outsourcing charges paid to US Company is not Fees for Technical Services

Taxpayer, an Indian Company, is engaged in the business of providing technology, consulting, and litigation support services with focus on IP domain (especially patent to companies, law firms and other technology investment and license firms). For FY 2014-15, the tax officer made the following disallowances under section 40(a) for non-deduction of tax:

- Outsourcing charges payable to its US Subsidiary - INR 71.1 mn
- Sales commission - INR 4.5 mn paid to a non-resident
- Provision for expenses – INR 1.17 mn created on 31 March and reversed on 1 April

As the taxpayer did not receive the relief from the First Appellate Authority, the taxpayer filed an appeal before the Bangalore Tax Tribunal. While granting relief to the taxpayer, the Bangalore Tax Tribunal made the following observations:

Re. Services rendered by US subsidiary

- Services rendered by US subsidiary were in connection with patent registration, patent litigation and procuring evidence for patent litigation and similar services. Further, since the customers of taxpayer are based in USA, taxability of payment received by US subsidiary (tax resident of USA) has to be tested basis the relevant clauses i.e. Article 12 of India-USA DTAA.
- Tax officer has made incorrect interpretation of 'make use' to be equivalent to 'make available' of technical knowledge. The analysis provided in the memo prepared by the employee of US subsidiary was only made a part of the final deliverable. The same did not result in the employee of the taxpayer being enabled to be in a position to arrive at the analysis done by the employee of US subsidiary independently in future, due to absence of the requisite knowledge.
- Tax officer has incorrectly interpreted that the US Court's protective order provided access to confidential source code to counsel's support personnel which includes taxpayer's employees.

TAX UPDATES
Direct Tax

- US subsidiary's employees who were given access to the protective information under the protective order were made to sign an undertaking providing that they shall not divulge information to anyone.
- US subsidiary's employees fulfil the criteria of the relevant US statutory requirements to be able to access the protective information. Thus, tax officer failed to appreciate that owing to the legal restrictions in the US, taxpayer's US subsidiary or its employees did not have an opportunity or any occasion to 'make available' any technical knowledge to the taxpayer or its employees while rendering services.
- Other services provided by US subsidiary were purely litigation oriented or services with regard to patent registration or patent search process. These services by no stretch of imagination can be considered as making available any technical knowledge to the taxpayer. Consequently, there was no obligation on the part of the taxpayer to deduct tax at the time of making payment.

Re. Sales commission

Non-resident was paid commission based on sales order procured. Merely because he was technically qualified, sales commission paid for enabling sales cannot become payment for rendering technical services. In terms of Article 15 of the India-USA DTAA, sales commission qualifies as income derived by a person from the performance of professional services and therefore shall be taxed in the country of residence except where such person has a fixed base regularly available to him in India for the purpose of performing his activities or stayed in India for 90 days or more in the relevant FY. Since neither of these conditions are satisfied, sales commission paid to the non-resident is not taxable under Article 15 of the India-USA DTAA.

Re. Provisions created on 31 March

The statutory provisions require deduction of tax at source even when the nomenclature used by the taxpayer for describing an expenditure as in the nature of suspense account or a profession. Accordingly, it directed the Tax Officer to ensure said amount should not be taxed in the year of its reversal.

[M/s IRunway India Private Limited Vs. DCIT, ITA 229/Bang/2019 (Bangalore Tribunal)]

Delhi High Court elaborates procedures for issuance of a reassessment notice under the new regime

Taxpayer, a member of National Stock Exchange and Bombay Stock Exchange, filed a writ petition challenging the show cause notice issued under section 148A(b)[2] of the IT Act as well as order passed under section 148A(d)[3] of the IT Act and consequential reassessment notice issued under section 148 of the IT Act. Taxpayer also challenged the legal validity of the notice under section 148A(b) of the IT Act on the ground that there was no information that suggested that income had escaped assessment. It was also contended that the order passed under section 148A(d) of the IT Act is arbitrary, cryptic and without application of mind. Further, it was contended that the response filed by the taxpayer to the show cause notice was not considered. Delhi High Court quashed the reassessment order and remanded it to the Tax Officer for fresh adjudication with a direction to pass a reasoned order under section 148A(d) of the IT Act after considering the detailed submission filed by the taxpayer. While holding this, it made following observations:

- **Reassessment Scheme and the term 'information'**
  - The new reassessment scheme was introduced by the Finance Act 2021 with the intent of reducing litigation and to promote ease of doing business. Under the amended provisions, the term "information" cannot be lightly resorted to, so as to re-open assessment. This information cannot be a ground to give unbridled powers to the revenue authorities.
  - Whether it is "information to suggest" under new reassessment scheme or "reason to believe" under old reassessment scheme, the benchmark of "escapement of income chargeable to tax" still remains the primary condition to be satisfied before invoking section 147 of the IT Act.
  - Revenue authorities classifying a fact already on record as "information" may vest it with the power to issue a notice of re-assessment under section 148A(b) of the IT Act but would certainly not vest it with power to issue re-assessment notice under section 148 of the IT Act post an order under section 148A(d) of the IT Act.
- **Impugned show cause notice as well as order is cryptic**

  The impugned show cause notice as well as order is cryptic as evident from the fact that information culled out from taxpayer's own return and records (namely Form 10DB, GST return, Form 26AS) was used to issue notice under section 148A(b) of the IT Act without mentioning as to what was wrong in these transactions, what were the apprehensions of the tax officer, and what were the points on which clarification was required.
- **Taxpayer denied with an effective opportunity to file a reply**

  The information stated in the show cause notice issued under section 148A(b) of the IT Act was not shared with the taxpayer, despite a specific request made by the taxpayer. Thus, taxpayer was deprived off an effective opportunity to file a response/reply. The non-sharing of the information is violative of the rationale laid down in the judgement of Sabh Infrastructure Ltd.[4]

[2] Section 148A(b) of the IT Act provides an opportunity of being heard to the taxpayer by serving upon him a show cause notice as to why a notice under section 148 of the IT Act should not be issued on the basis of information suggesting that income chargeable to tax has escaped assessment.

[3] Section 148A(d) of the IT Act allows tax officer to decide on the basis of material available on record (including reply by taxpayer), whether or not it is a fit case to issue a notice under section 148 of the IT Act.

[4] Sabh Infrastructure Ltd Vs. ACIT [398 ITR 198] (Delhi High Court)

TAX UPDATES
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- **Taxpayer not given reasonable time to file a reply**

  The taxpayer has a right to get adequate time to submit its reply. In the present case, the impugned order under section 148A(d) of the IT Act was passed in great haste and in gross violation of the principle of natural justice as the taxpayer was not given reasonable time to file a reply.

- **Mandate of section 148A(c) of the IT Act was violated**

  Taxpayer had filed two replies in response to the impugned show cause notice. However, revenue authorities did not considered the second reply by contending that the same was filed beyond the time given to the taxpayer. Since the order under section 148A(d) of the IT Act was passed after receipt of the second reply by the taxpayer, the tax officer should have considered the same as it was available on record. By not considering the second reply, the mandate of section 148A(c) of the IT Act was violated as it casts a duty on the tax officer, by using the expression 'shall', to consider the reply of the taxpayer in response to the show cause notice under section 148A(b) of the IT Act before making an order under section 148A(d) of the IT Act.

- **Significance of issuing a show cause notice at a stage prior to issuance of a reassessment notice under section 148 of the IT Act has been lost**

  In a majority of reassessment cases post 1 April 2021, the order under section 148A(d) of the IT Act use a template/general reason to reject the defense of the taxpayer on merits. Such action has not only rendered implementation of new reassessment regime meaningless but also had an unintended opposite result.

  [Divya Capital One Private Limited Vs. ACIT, WP No. 7406/2022 (Delhi High Court)]

- **Supreme Court treats reassessment notices issued between April to June 2021 under old regime as valid**

  The Finance Act, 2021 introduced new procedure for reassessments effective from 1 April 2021. Post 1 April 2021 (i.e. after the amended provisions for reassessment became effective) the tax authorities issued about 90,000 reassessment notices between April-June 2021 as per the old procedure. Such issuance of notices was challenged in Writ Petitions before various High Courts across the country. The matter was then referred to Supreme Court who recently pronounced its ruling on the validity of these notices. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-supreme-court-treats-reassessment-notices-issued-between-april-to-june-2021-unde

  [Union of India and others vs. Ashish Agarwal, Civil Appeal No. 3005/2022, (Supreme Court)]

- **Support charges and training fees' reimbursement not taxable as FTS under India-USA DTAA**

  Taxability of amount received towards support services has always been a vexed issue. Recently, Delhi Tax Tribunal has held that amount received towards support services is not taxable in India in terms of India-USA DTAA. Further, it also held that the reimbursement of the cost of training given to the new recruits does not come within the ambit of Fees for Technical Services as there is no transfer of or sharing of any technical knowledge, experiences, skills, know how or processes by way of training. Hence, Delhi Tax Tribunal held that such reimbursement is not taxable in India. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-support-charges-and-training-fees%E2%80%99-reimbursement-are-not-taxable-as-fts-under-ind

  [Russell Reynolds Associates Inc. Vs DCIT (International Taxation), ITA No.1165/Del/2019 (Delhi Tribunal)]

- **No Taxes to be withheld by Reinsurers on payment of ceding commission as the same is reimbursement of costs**

  Recently the Delhi Tax Tribunal upheld the view taken by various courts in India that, ceding commission is in the nature of reimbursement of costs and hence not liable for tax withholding at source. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-no-taxes-to-be-withheld-by-reinsurers-on-payment-of-ceding-commission-as-the-same

  [Axa France Vie Vs. ACIT, ITA No. 439/Del/2022 (Dehradun Tribunal)]

- **No disallowance of reinsurance payments to foreign re-insurers under section 37(1) and/ or 40(a)(ia) of the Income-tax Act, 1961**

  Every insurer, in consideration of payment of reinsurance premium, re-insures himself against the risks arising out of the conduct of insurance business. However, such payment of reinsurance premium made to foreign reinsurer has always been subject matter of debate with tax authorities in India. In this regard, recently, the Mumbai Tax Tribunal had an occasion to examine whether such reinsurance payments to foreign reinsurers are entitled for a deduction as a business expenditure and whether such payment of reinsurance premium paid to foreign reinsurers is subject to withholding tax in India. To read our detailed analysis, please go to: https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-no-disallowance-of-reinsurance-payments-to-foreign-re-insurers-under-section-37(1)

  [Tata AIG General Insurance Company Ltd Vs. DCIT, ITA No. 1718/Mum/2020 (Mumbai Tribunal)]

TAX UPDATES
Transfer Pricing

Tax Tribunal upholds use of Customs valuation data for determining Arm's length price of import transaction

The taxpayer had contended that the international transaction of purchase of fuel oil/HSD should be benchmarked using the customs valuation data. The taxpayer relied on the decision of the Chennai Tax Tribunal in the case of Coastal Energy Pvt Ltd. v. ACIT [2011] 12 taxmann.com 355. The CIT(A) upholding the taxpayer's contention directed the TPO to benchmark the international transaction using the customs data. The Revenue challenged the order of the CIT(A) before the Delhi Tax Tribunal.

The Delhi Tax Tribunal upheld the order of CIT(A) which had relied on the decision of the Chennai Tax Tribunal in the case of Coastal Energy Pvt Ltd. (supra). CIT(A) had held that the **valuation was made by customs authorities by assigning values to import of goods on the basis of scientifically formulated methods as they were responsible for making fair assessment of value of the imported goods according to internationally accepted protocols.** The Delhi Tribunal rejected the appeal filed by the Revenue holding that there was no infirmity in the order of the CIT(A).

ACIT Vs. GP Global Energy Pvt Ltd [TS-325-ITAT-2022(DEL)-TP]

Amortisation of goodwill on purchase of business on slump sale basis is a non-operating expenditure for transfer pricing purpose

The taxpayer (TECSIPL) was a wholly owned subsidiary of Tyco Electronics Singapore Pte Ltd, Singapore. It was engaged in providing IT enabled services to the TE Group entities across the globe. The taxpayer purchased the shared services business of the CommScope Connectivity India Private Limited that supported the business operations of the Group. The business was purchased on slump sale basis for an amount or INR 68.55 crores and the goodwill had arisen out of such purchase consideration paid. Amortization of goodwill was charged to P&L account.

Taxpayer's contentions

Goodwill represents the excess of purchase consideration paid over and above the fair value of net assets taken over in anticipation of future economic benefits which are not immediate but accrue over a period of time. Although the said goodwill was not recorded or recognised by the transferor prior to the said acquisition, the same arose pursuant to the acquisition on account of the significant premium paid for the business. It is therefore a cost associated with the purchase of the business and it is not a tool deployed in business.

Unlike assets such as plant and machinery, office equipment, computers, laboratory equipment, etc., which are purchased and used for undertaking the normal day-to-day operations, "goodwill" is the price paid for acquiring an on-going business. The same is amortized/ impaired in the books of account, over a period of time as required by the accounting standards, and such period does not necessarily coincide with the actual period over which the business will reap benefits from such payment. Hence, the purchase of goodwill cannot be equated to other capital assets used for running the business. It is therefore not an operating expense in the regular course of business but is the cost of acquisition and an extraordinary item and should not be considered as operating in nature for computing the taxpayer's margin on cost.

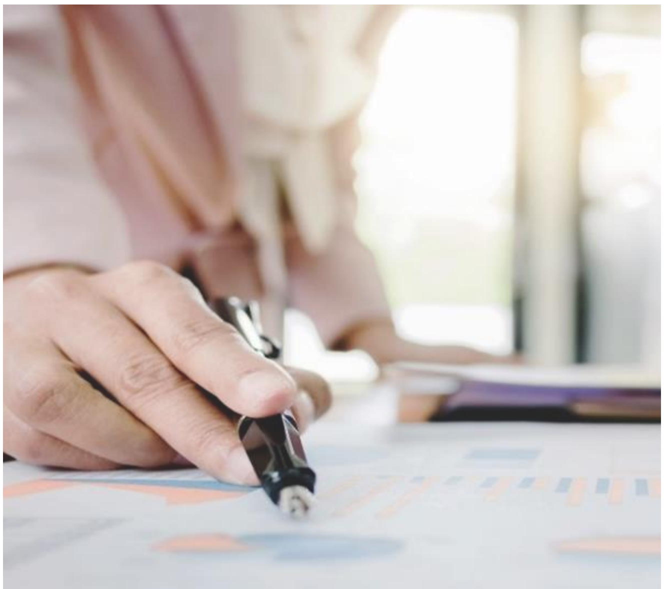
Department's contention

Amortization of goodwill is the process of expensing the cost of a goodwill over the projected life of the asset for tax or accounting purposes. The intangible assets, such as goodwill, patents and trademarks are amortized into an expense account whereas tangible assets are instead written off through depreciation. Thus, amortization of goodwill like depreciation falls under the category of operating expenses.

Tax Tribunal decision

The Tax Tribunal held in favour of the taxpayer that the amortization of the goodwill should be considered as non-operating expenditure for computing the operating profit margin of the taxpayer. The Tax Tribunal relied on coordinate bench ruling in Continental Automotive Components (India) Pvt. Ltd which in turn had relied on Delhi ITAT ruling in St Ericsson India Private Limited and treated amortisation of goodwill resulting on account of an extra-ordinary circumstances as non-operating expenditure.

TE Connectivity Services India Pvt Ltd V. AO, National Faceless Assessment Centre, Delhi [TS-330-ITAT-2022(Bang)-TP]



TAX UPDATES
Indirect Tax

GOODS & SERVICE TAX

JUDICIAL UPDATES

WRIT PETITION

Change in the constitution of business from partnership firm to private limited company will not deprive the taxpayer from availing the ITC

Facts of the case

- M/s. Travancore Mats and Mattings Pvt Ltd ('Taxpayer') is a dealer registered under GST regime. The taxpayer has paid GST @ 12% on the good manufactured by him during the period July 2017 to October 2017. However, subsequently the taxpayer started paying GST @ 5% on the supplies made by him from November 2017 till April 2019 and filed the returns respectively;
- The taxpayer was initially a partnership firm which has been subsequently converted into private limited company having its branch office at Tamil Nadu and Head Office at Kerala;
- Tax authorities had issued notice under section 61 of the CGST Act, 2017 for scrutiny of returns for which the taxpayer replied to the notice. Despite replying to the notice, once again a notice for intimating discrepancies in the return was issued on 07 October 2021;
- The taxpayer has filed Writ petition challenging the above notices. Though the challenge was made, the taxpayer has accepted to pay the differential tax of 7% demanded by the tax authorities.

Contention of the Taxpayer

- The taxpayer submitted that, if they make payment of entire taxes of 12% for the period November 2017 to April 2019, the taxpayer would be eligible to claim ITC from his HO at Kerala state;
- It was further submitted that, once the payment is made and an application is made before tax authorities, the ITC claim made by the taxpayer can be permitted to be considered by the State Tax Authorities.

Contention by Tax authority

- The tax authority has contended that, though the taxpayer has paid 12% for the period July 2017 and October 2017, suddenly they started paying lesser percentage i.e., 5% from November 2017 till April 2019;
- It was also submitted that, since initially the taxpayer was a partnership firm, which was subsequently converted into a private limited company, therefore, the GSTN provided for the old partnership firm has got changed to the new GSTN to a private limited company;
- An intimation for payment of tax issued subsequent to filing of the reply to notice shall not be construed as unlawful or arbitrary or against the provisions of the Act;
- It was contended that, once the total tax is paid by the taxpayer, the taxpayer would be eligible to avail ITC at H.O by making claim before Kerala GST authorities and Tamil Nadu GST authorities does not have any role to play.

Ruling by the High Court

- If the taxpayer is ready and willing to make the payment for the remaining 7% of the tax for the period November 2017 to April 2019, the taxpayer is liable to make the payment of said demand within a period of two weeks from the date of receipt of order;
- If the taxpayer is eligible to claim the said ITC, the taxpayer can claim ITC from the concerned Jurisdictional state authority where the HO is located by filing the return at the Kerala tax authorities and the same shall be considered as per the eligibility of the taxpayer within the meaning of the provisions of the GST Act;
- Further, as there is a mere change in constitution of the taxpayer from partnership firm to private limited company, the taxpayer shall not be considered as different dealer or entity for claiming the ITC if he is eligible to claim ITC as per the provisions of GST Act.

[Madras High Court-M/s. Travancore Mats and Mattings Private Limited v/s Assistant Commissioner, Writ Petition No. 2869, 2875, 2876, 2995, 2997 & 2998 of 2022 dated 15 March 2022]

Rule 86A shall be exercised only when the officer has reason to believe that credit of ITC in the electronic credit ledger has been fraudulently availed or the taxpayer is ineligible

Facts of the case

- M/s. Rajnandini Metal Ltd ('taxpayer') is engaged in the manufacturing of copper wire rod and submersible winding wire;
- Taxpayer received supplies from seven different suppliers (based in Delhi & Jaipur) who are part of a chain/racket involved in generation and passing on of fake ITC, without any actual supply. The total amount of ITC received from these seven suppliers amounting to INR 527.9 Mn which includes ITC of INR 107.2 Mn from M/s. Bhagwati Metals;
- M/s. Bhagwati Metals, one of the suppliers of the taxpayer is found to be non-existing and has been issued with show cause notice for cancellation of registration on 5 February 2021. The same proceeding was dropped on 23 February 2021. However, from 1 July 2021 proceeding was initiated again and the GSTIN was cancelled with effect from 27 July 2021;

TAX UPDATES
Indirect Tax

- Due to this issue, tax authorities blocked ITC of the taxpayer amounting to INR 19 Mn lying in the electronic credit ledger by invoking the provisions under rule 86A of the CGST Rules, 2017.

Contention of the Taxpayer

- Taxpayer filed representations objecting to such action of the tax authorities which remained undecided. Therefore, Writ petition was filed, which was decided on 6 December 2021 directing the tax authority to decide the said representation in accordance with law by passing a speaking order thereon within a period of seven days;
- The misappropriation or fraud, if any has been committed by suppliers of the taxpayer for which taxpayer cannot be deprived from his valuable right of ITC. The denial of ITC is violative of Article 19(1)(g) and Article 21 of the Constitution of India;
- The taxpayer relied on the ruling of M/s. New Nalbandh Traders vs State of Gujarat and 2 others, special civil application no. 17202 of 2021 dated 23 February 2022.

Contention by Tax authority

- Tax authority rejected the arguments of the taxpayer seeking unblocking of its ITC vide order dated 17 December 2021;
- The taxpayer has approached the High Court seeking quashing of the order dated 17 December 2021.

Ruling by the High Court

- Power under rule 86A of the CGST Rules is exercised where the prescribed officer has reason to believe that credit of ITC in the electronic credit ledger has been fraudulently availed or the taxpayer is ineligible. The exercise vested in the prescribed authority is subject to a satisfaction recorded by the said authority and forming opinion to the effect that the credit ledger has been fraudulently availed or the taxpayer is ineligible in the situations as prescribed;
- Rule 86A undoubtedly could be said to have conferred drastic powers upon the proper officers if they have reason to believe that the activities or invoices are suspicious. The rule 86A is based on "reason to believe". "Reason to believe" must have a rational connection with or relevant bearing on the formation of the belief. It is a subjective term and can be interpreted differently by different individuals;
- There is no reason recorded by the authority for exercising power under rule 86A of the CGST Rules, 2017 which would show independent application of mind that can constitute reasons to believe which is sine qua non for exercising power under rule 86A of the CGST Rules, 2017;
- Consequently, the Writ petition is allowed. The impugned order dated 17 December 2021 (Annexure P-18) is set aside.

[High Court of Punjab And Haryana-M/s. Rajnandini Metal Ltd, CWP No. 26661 of 2021 (O&M), dated 31 May 2022]

ORDERS BY APPELLATE AUTHORITY FOR ADVANCE RULING (AAAR)

ITC shall not be availed on inputs, input services and capital goods procured to construct LNG jetties

Facts of the Case

- M/s. Swan LNG Pvt. Ltd. (‘Taxpayer’), has entered into a concession agreement with the Gujarat Maritime Board and Government of Gujarat for development, construction, operation, and maintenance of Liquefied Natural Gas ('LNG') port with a Floating Storage and Regasification Unit ('FSRU') facility in Gujarat, on Build, Own, Operate and Transfer (BOOT) basis;
- As a part of developing the LNG port and FSRU facility, the taxpayer is developing an import terminal for FSRU near the village Bhankodar, Gujarat. After development of the said import terminal, the taxpayer intends to provide LNG regasification service to prospective customers.

Questions before the AAR

- Whether in terms of section 17 of the CGST Act, 2017 the LNG jetties proposed to be built by the taxpayer can be said to be covered within expression 'plant and machinery' as foundation to equipment, apparatus, machinery to be installed on it?
- Whether as per section 16 read with section 17 of the said Act, the taxpayer can accordingly avail ITC of GST paid on inputs, input services as well as capital goods procured for the purpose of building the LNG jetties?

Contention of the taxpayer

The taxpayer contended that LNG Jetty being constructed by them is 'foundation' of the 'plant and machinery' to be installed on it for making outward supply; therefore, such foundation is included in the expression "plant and machinery", as defined in the explanation to section 17 of the CGST Act, 2017.

Ruling by the AAR

- Gangway towers, fire monitor towers and jetty substations are civil structures and are therefore not covered under 'plant and machinery', whereas the remaining equipment appeared to be covered under the definition of apparatus, equipment or machinery;
- The apparatus, equipment and machinery are not fixed to the earth by foundation or structural support, that they are to be fixed to the jetties which by themselves do not fall under the definition of 'foundation' or structural support;
- In absence of any submission of the taxpayer regarding use for making outward supply, the AAR concluded that the aforementioned apparatus, equipment, and machinery are not involved in the outward supply of goods or services;
- The LNG jetties proposed to be built by the taxpayer are not covered within the expression 'plant and machinery' as foundation to equipment, apparatus, machinery and thus, the taxpayer cannot avail ITC of GST paid on

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Indirect Tax

inputs, input services as well as capital goods procured for the purpose of building the LNG jetties in terms of section 16 read with section 17 of the CGST Act, 2017;

- Aggrieved by the above ruling, the taxpayer has filed appeal before the AAAR.

Observations and Ruling by the AAAR

- Section 17 of CGST Act, 2017 provides for allowing ITC in respect of goods or services both received by a taxable person for construction of plant and machinery fixed to earth by foundation or structural supports that are used for making outward supply of goods or services or both;
- ITC on construction of foundation is allowed if the following three elements are fulfilled:
  - The foundation should be exclusively used for fixing of plant on machinery on it;
  - Further items to be fixed on the foundation should be 'plant and machinery' means apparatus, equipment, and machinery. Plant and machinery include items that are needed for doing something or does something;
  - The plant and machinery fixed to earth by foundation or structural supports should be used for making outward supply of goods or services or both.
- The ITC in respect of construction of foundation and structural supports of plant and machinery is not deniable in terms of section 17(5), however, ITC in respect of construction of building or any other civil structure is not admissible;
- The equipment like gangway towers, fire monitor towers and jetty substations are civil structures and therefore not covered under 'plant and machinery', whereas the remaining equipment viz. LNGC unloading arms, FSRU loading arms, HP gas unloading arms, cold drain tanks and nitrogen buffer vessels appear to be covered under the definition of apparatus, equipment or machinery. When these are "plant and machinery", their foundation and structural supports are also covered under the expression "plant and machinery", as per the statutory provisions of section 17. However, these apparatus, equipment and machinery are not fixed to the earth by foundation or structural support. The same are to be fixed to the jetties which by themselves do not fall under the definition of 'foundation' or structural support;
- The requirement/essentiality of anything for providing outward supply, does not ipso facto make the same entitled for ITC. For example, land, building, other civil structures like jetty and pipeline laid outside the factory premises may be required and essential for making outward supply; however, ITC of GST paid on construction of the same is not admissible under the provisions of section 17 of the CGST Act, 2017. Whereas ITC in respect of immovable property, which is in the nature of 'plant and machinery' including foundation and structural supports thereof, is admissible under the same provisions;
- LNG Jetties are nothing, but civil structures and civil structures are excluded from the definition of foundation and structural supports;
- The foundation that is allowed in the definition of plant and machinery is that which fixes the plant and machinery to the earth making it immovable. If certain portion of LNG jetties is used for directly fixing plant and machineries, then it will not make jetties foundation for plant and machineries, but they are only in the nature of civil structures. The taxpayer has also not produced any evidence to substantiate their claim that LNG jetties which according to them are foundation of plant and machineries will be used for outward supply of goods or services or both;
- The AAAR held that the LNG jetties being built by the taxpayer are not in the nature of 'plant and machinery' being foundation for equipment, apparatus, machinery for re-gasification. Therefore, ITC on inputs, input services and capital goods for the purpose of building these LNG jetties are not admissible,

[AAAR-Gujarat, M/s. Swan LNG Pvt. Ltd. Ruling no: GUJ/GAAAR/APPEAL/2022/06, dated 09 May 2022]

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