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ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

EAC OPINION

Accounting Treatment Of Additional Capitalisation Arisen Due To Arbitration Award

Facts Of The Case

A company (hereinafter referred to as 'the Company'), a Maharatna Public Sector Undertaking (PSU), is the leading steel-making company in India having five integrated steel plants and three special steel plants. The Company produces both basic and special steels for domestic construction, engineering, power, railways, automotive and defence industries as well as for sale in export markets.

At one of the integrated steel plants of the Company, an order was placed with a consortium of T Ltd. and DCBV in 2008 for setting up a 1x4060 cubic metre blast furnace on a turnkey basis at a contract value of (EURO 73,982,760 + INR 1217,00,00,000/-). The duration of the project was 30 months from the date of the contract and the scheduled date of commissioning was 1 April 2011, which was delayed, and actual commissioning took place on 17 October 2014.

The Company has stated that the delay was attributable to the contractor and the Company demanded liquidated damages for the delay as per the terms of the contract. The price variation was paid to the contractor for the scheduled period only as the price variation is not payable for the period when the delay is on account of the contractor.

The contractor did not accept the delay. Rather, they had raised various claims on account of extra work, price variation, prolongation cost and interest etc. which could not be mutually resolved. The consortium members invoked arbitration under the International Chamber of Commerce (ICC) in three cases as listed below and the arbitral award was against the Company in all three cases. The arbitration award amount was INR 710.99 crore + interest till the date of payment.

The arbitral awards were challenged by the Company in the Hon'ble Delhi High Court in 2018 and 2019. Meanwhile, a committee of senior officials was constituted for a mutual commercial settlement. The committee held multiple rounds of discussions with the consortium of T Ltd./DCBV. The final offer by T Ltd./DCBV was a lump sum amount of INR 628.32 crore (INR 470.31 crore + EURO 18,567,148) plus income tax on foreign services, which was considered acceptable. At this point in February 2022, the award amount including interest and offered by the contractor for settlement was as under: Award amount – Basic award INR 710.99 crore + Interest INR 274.73 crore = INR 985.72 crore offer given by the contractor for settlement = INR 628.32 crore + Income Tax after approval of the competent authority in February 2022, a settlement agreement was signed with M/s T Ltd./DCBV in March 2022 and payment of INR 637.35 crore (including income tax on foreign services) was made to M/s T Ltd./ DCBV under the following heads:

- Prolongation cost including interest - INR 353.41 crore
- Balance Amount (as per contract) - INR 142.95 core
- Extra Price variation claim - INR 119.39 crore

- Extra civil work – INR 10.63 crore
- Additional Design Engineering cost - INR 10.97 crore

Total INR 637.35 crore

Accounting Treatment:

- After arbitration was invoked by the contractor, the claim amount of INR 962.51 crore was shown under contingent liability until the same was confirmed in March 2022.
- On payment in March 2022, prolongation cost including interest for INR 353.41 crore was charged to revenue in the Statement of Profit and Loss.
- Items (b to e) amounting to INR 283.94 crore were capitalised. Liability for INR 153.71 crore was already existing in the books on capitalisation of the asset in 2014. The balance amount of INR 130.23 crore was capitalised w.e.f. March 2022 prospectively.

Observation of Comptroller and Auditor General of India (CAG) The resident audit (government audit) observed that INR 130.23 crore which was capitalised in March 2022 pertains to payments towards extra work and price escalation amount. The above works have already been completed before the commissioning of the original asset, i.e., 17 October 2014. The Company has been getting benefits out of it since commissioning and the amount was capitalised in the financial statements during the year 2021-22 out of the mutual settlement. Therefore, the depreciation against the capital addition made in the year 2021-22 out of an amicable settlement agreement should have been charged from the date of initial capitalisation (i.e. since 1 September 2014) instead of from the date of addition.

Basis of additional capitalisation w.e.f. March 2022 The additional capitalisation is on account of extra price variation, extra civil work and additional design engineering which has been paid to the contractors due to an arbitration award given in their favour. The asset was capitalised on 1 September 2014 without considering the aforesaid claims of the contractor because the same was not contractually payable and the claim of the contractor was put to legal scrutiny through various redressal forums. Since the liability arises because of the arbitrator's award and not because of the provision of the contract, the same was capitalised prospectively in accordance with paragraph 5 (a) of Appendix A, 'Changes in Existing Decommissioning, Restoration and Similar Liabilities' to Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment', which states that: "5 If the related asset is measured using the cost model:

- Subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.
- The amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss. …"

As per paragraph 37 of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors: "To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change." Further, it is noted that Notes to the financial statements of the Company disclose that where the historical cost of a depreciable asset undergoes a change, the depreciation on the revised unamortised depreciable amount is provided over the residual useful life of the asset. Accordingly, depreciation on the addition to the asset has been charged on a prospective basis. According to the Company, the accounting treatment of INR 130.23 crore in the Company's books of account complies with the requirements of Ind AS 16, Ind AS 8 and the prevailing accounting policy of the Company.

Query

The opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India is sought on the following issues:

- Whether the contention of C&AG that INR 130.23 crore should be depreciated retrospectively, i.e., from the original date of capitalisation, or
- The accounting treatment of additional capitalisation and depreciation followed by the Company, is in accordance with the requirements of Ind AS 16, Ind AS 8 and the prevailing accounting policy of the Company.

Points Considered By The Committee

The Committee notes that the basic issue raised by the Company relates to accounting for additional capitalisation on account of extra price variation claims, extra civil work, additional design engineering cost, and depreciation thereof. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as any other expense incurred by the Company in relation to the project, accounting as per Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets', including appropriateness of liability/provision created in 2014 and disclosure as a contingent liability after invoking of arbitration by the contractor till the claim amount was confirmed in March 2022, accounting for prolongation cost (including interest), accounting for foreign exchange variation (if any), appropriateness of the Company's accounting policy, etc. The Committee also wishes to point out that since the query pertains to financial year (F.Y.) 2021-22, the opinion expressed hereinafter is in the context of Indian Accounting Standards (Ind ASs) notified under the Companies (Accounting Standards) Rules, 2015, applicable for the F.Y. 2021- 22. Further, the opinion expressed hereinafter is purely from an accounting perspective and not from a legal perspective, such as legal interpretation of various agreements/contracts entered into by the Company, arbitration award, etc.

At the outset, the Committee notes from the Facts of the Case that one of the integrated steel plants of the Company placed an order for a blast furnace for which actual commissioning took place in 2014. As the project was delayed, the Company demanded liquidated damages, however, the contractor did not accept the delay and raised various claims against the Company on account of extra work, price variation, prolongation cost and interest etc. In 2022, a settlement agreement was signed, and the amount of INR 283.94 crore (excluding prolongation cost) was determined as compensation for various elements including balance amount (as per contract), extra price variation claim, extra civil work, and additional design engineering cost. A liability for INR 153.71 crore was already provided for in respect of the above elements in the books on capitalisation of the asset in 2014 and a balance amount of INR 130.23 crore was capitalised w.e.f. March 2022 prospectively.

In this context, the Committee examines the following requirements of Ind AS 16:

"7 The cost of an item of property, plant and equipment shall be recognised as an asset if, and only if:

- Future economic benefits associated with the item will probably flow to the entity; and
- The cost of the item can be measured reliably."

"10 An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it. ..."

"15 An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.

Elements of cost

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."

The Committee notes from the above-reproduced requirements of Ind AS 16 that only those costs/expenditures that are directly attributable to bringing the item of PPE to the location and condition necessary for it to be capable of operating in the manner intended by management should be capitalised as part of the cost of PPE. Since the additional cost incurred towards additional design engineering cost, extra civil work, price variation claims etc. has been contended by both the management and the C&AG auditor to be capitalised as part of the cost of the steel plant/blast furnace in the extant case, the Committee presumes that the same is a directly attributable cost as per the requirements of Ind AS 16 and accordingly, can be capitalised as part of the cost of the plant. The Committee also presumes that all these items of costs pertain to the pre-capitalisation period of the plant/asset (i.e. prior to commissioning of the plant on 17 October 2014 in the extant case); In other words, these do not include any new item of cost which might have arisen after capitalisation of asset.

The Committee further notes that as per the requirements of paragraph 15 of Ind AS 16, an item of PPE shall be measured at recognition at cost. The Committee also notes that in the extant case, the cost of the plant includes an element of an estimate of INR 153.71 crore towards extra price variation claim, extra civil work, and additional design engineering cost at the time of capitalisation of the asset (Plant) in 2014, actual cost of which got crystalised in 2022 at a higher amount and therefore, the same is a change in estimate of the cost of PPE, which should be accounted for as a change in accounting estimates in accordance with the following requirements of Ind AS 8:

"1 A change in accounting estimate is an adjustment of the carrying amount of an asset or a liability or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with assets and liabilities. Changes in accounting estimates result from new information or new developments and accordingly, are not corrections of errors."

"36 The effect of change in an accounting estimate, other than a change to which paragraph 37 applies, shall be recognised prospectively by including it in profit or loss in:

- The period of the change, if the change affects that period only; or
- The period of the change and future periods, if the change affects both.

37 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change."

From the above, the Committee notes that the change in estimate due to adjustment of the carrying amount of an asset should be recognised prospectively by adjusting the carrying amount of the related asset in the period of the change. Thus, in the extant case, the additional amount incurred towards the cost of the asset due to a change in the initial estimate of the cost of the asset arising because of the settlement of the provision/liability towards design engineering cost, extra civil work, price variation claims etc., should be capitalised with the cost of the PPE/ asset(s) prospectively. Further, the depreciation on the

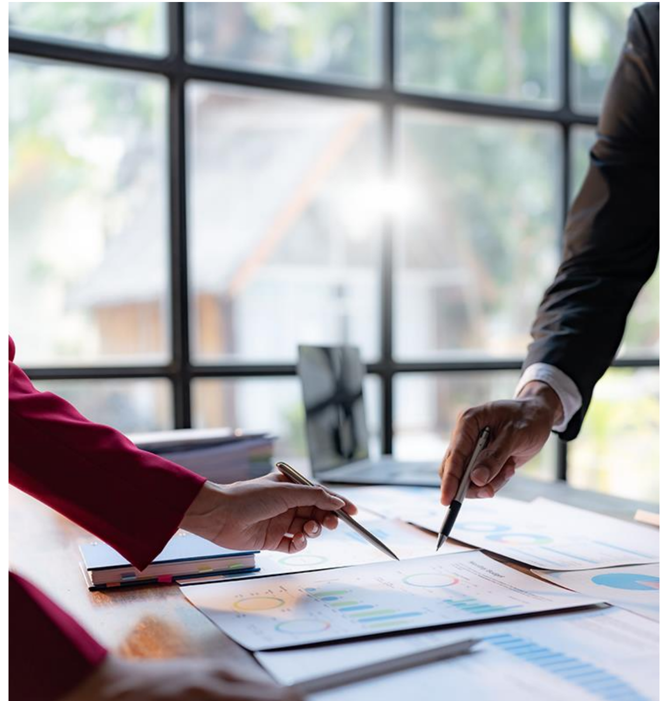
amount capitalised subsequently due to a change in estimate should be charged prospectively. However, the resulting carrying amount of such asset should be reviewed for impairment as per the requirements of Ind AS 36, 'Impairment of Assets'.

Accordingly, the accounting treatment of additional capitalisation and depreciation followed by the Company is in accordance with the requirements of Ind AS 16 and Ind AS 8.

Opinion

On the basis of the above and subject to presumptions made in the paragraph above, the Committee is of the following opinion on the issues raised in the paragraph above:

- The addition to the asset of INR 130.23 crore should be depreciated prospectively as discussed in the paragraph above.
- The accounting treatment of additional capitalisation and depreciation followed by the Company is in accordance with the requirement of Ind AS 16 and Ind AS 8, as discussed in the paragraph above.



REGULATORY UPDATES

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Standardisation Of The Private Placement Memorandum (PPM) Audit Report

In terms of regulations and circulars issued previously, it is mandatory for AIFs to carry out an annual audit of compliance with the terms of the Private Placement Memorandum (PPM) and to submit Annual PPM Audit Reports within 6 months from the end of the Financial Year.

On 8 April 2024, SEBI issued a circular on the Standardisation of the Private Placement Memorandum (PPM) Audit Report.

A standard reporting format has been introduced for ease of compliance, to be hosted on AIF association websites within 2 days of the circular. The associations shall assist all AIFs in understanding the reporting requirements and in clarifying or resolving any issues which may arise in connection with reporting to ensure accurate and timely reporting. This shall be applicable for PPM audit reports to be filed for the Financial Year ending 31 March 2024 onwards.

The PPM audit reports shall be submitted to SEBI by AIFs online on the SEBI Intermediary Portal (SI Portal) as per the aforesaid format.

Further, audit of the 'Risk Factors,' 'Legal, Regulatory and Tax Considerations,' 'Track Record of First Time Managers,' 'Illustration of Fees and Expenses,' and 'Glossary and Terms' sections of the PPM shall be optional.

This circular applies to all Alternative Investment Funds (AIFs)

Ease Of Doing Business: Text On Contract Note With Respect To Fit And Proper Status Of Shareholders

SEBI had received representations from market participants through the Industry Standards Forum (ISF) to relax the requirement of the Master Circular (Stock Exchanges and Clearing Corporations) dated 16 October 2023 of publishing the text pertaining to 'fit and proper' on the contract note in terms of Regulation 19 and 20 of the SEBI (Securities Contract (Regulation) (Stock Exchanges and Clearing Corporation) Regulations, 2018. In this regard, SEBI has issued a circular on Ease of Doing Business: Text on Contract Note with respect to Fit and Proper status of shareholders, dated 24 April 2024.

The circular has amended the above and requires only a reference to the applicable regulation with regard to fit and proper by mentioning the URL/weblink of Regulations 19 and 20 of the said Regulations to be made part of the contract note.

This circular applies to all recognised Stock Exchanges.

Securities And Exchange Board Of India (Alternative Investment Funds) (Second Amendment) Regulations, 2024

SEBI has issued an amendment to the Securities and Exchange Board of India (Alternative Investment

Funds) Regulations, 2012, dated 25 April 2024. These Regulations may be called the Securities and Exchange Board of India (Alternative Investment Funds) (Second Amendment) Regulations, 2024.

The following Regulations have been amended

Regulation 2(1)(ia) And 2(1)(ib): Definitions of "dissolution period" and "encumbrance have been added.

Regulation 2(1)(pb): The words "for fully liquidating the scheme" shall be omitted.

Regulation 16(1)(c) & 17(c) : New provisos have been inserted

Regulation 20(19)(20) Clause on exercising specific due diligence, with respect to their investors and investments has been inserted.

Regulation 29(9): The words "sell such investments to a liquidation scheme" have been replaced by the words "enter into dissolution period". Regulation 29(9)(9A) and (10): New sub-regulations have been added with regard to the expiry of the liquidation period and dissolution period.

Regulation 29A: Inserted new sub-regulation on the launch of any new liquidation scheme under this regulation

Regulation 29 B: Schemes entering into a dissolution period.

This shall come into force on the date of their publication in the Official Gazette.

This amendment applies to all alternative investment funds

Securities Contracts (Regulation) (Stock Exchanges And Clearing Corporations) (Amendment) Regulations, 2024

SEBI has issued an amendment to the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018, dated 26 April 2024. These regulations may be called the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) (Amendment) Regulations, 2024.

Regulation 38A has been inserted: "Administration of specified intermediaries" - Notwithstanding anything contained in these regulations, with the approval of the Board, the activities of administration and supervision over specified intermediaries may be carried out by recognised stock exchange on such terms and conditions and to such an extent as may be specified

This shall come into force on the date of their publication in the Official Gazette.

Securities And Exchange Board Of India (Research Analysts) (Amendment) Regulations, 2024

SEBI has issued an amendment to the Securities and Exchange Board of India (Research Analysts) Regulations, 2014, dated 26 April 2024. These regulations may be called the Securities and Exchange Board of India (Research Analysts) (Amendment) Regulations, 2024.

The circular amends/ inserts the following Regulation 6(xi), Regulation 14 and Paragraphs 1,2 and 3 of the Second Schedule.

This shall come into force on the ninetieth day from the date of the publication in the Official Gazette.

Securities And Exchange Board Of India (Investment Advisers) (Amendment) Regulations, 2024

SEBI has issued an amendment to the Securities and Exchange Board of India (Investment Advisers) Regulations, 2013, dated 26 April 2024. These regulations may be called the Securities and Exchange Board of India (Investment Advisers) (Amendment) Regulations, 2024.

The circular amends/ inserts the following Regulation 6(n), Regulation 14 and Regulation 30A.

This shall come into force on the ninetieth day from the date of the publication in the Official Gazette.

RESERVE BANK OF INDIA (RBI)

Master Circular - Basel III Capital Regulations

RBI has issued a Master Circular on Basel III Capital Regulations, dated 1 April 2024 which impacts all Scheduled Commercial Banks, excluding Small Finance Banks, Payments Banks and Regional Rural Banks. It has updated and amended instructions from the previous circular dated 12 May 2023, consolidating the prudential guidelines on Basel III capital adequacy issued to banks to the current date. Small Finance Banks and Payments Banks are directed to refer to their licensing and operating guidelines for prudential capital adequacy regulations.

The Circular is divided into six parts and includes 26 Annexures.

Part A: Minimum Capital Requirement (Pillar 1).

Part B: Supervisory Review and Evaluation Process.

Part C: Market Discipline.

Part D: Capital Conservative Buffer Framework.

Part E: Leverage Ratio Framework.

Part F: Countercyclical Capital Buffer Framework.

A list of circulars consolidated in this Master Circular is contained in Annex 26.

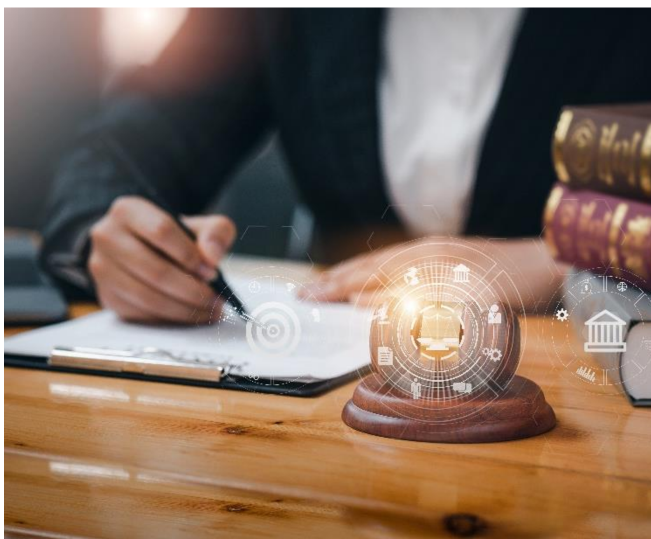
Master Circular On Conduct Of Government Business By Agency Banks - Payment Of Agency Commission

RBI has issued a Master Circular on Conduct of Government Business by Agency Banks - Payment of Agency Commission, dated 1 April 2024.

This is an update/ revision to the previously issued circular, consolidating instructions issued by RBI until 31 March 2024.

The Master circular includes general instructions on Government transactions eligible for agency commission, Government transactions not eligible for agency commission, Rates for agency commission, Claiming agency commission and Penal interest for wrong claims.

It impacts all Agency Banks.



Master Circular - Disbursement of Government Pension by Agency Banks

RBI has issued a Master Circular on Disbursement of Government Pension by Agency Banks, dated 1 April 2024.

This is an update to the previously issued circular, consolidating instructions issued by RBI until 31 March 2024.

The Master circular includes general instructions on Government orders on DR, etc. on websites, Prompt implementation of Government's instructions by agency banks, Timing of pension disbursement by agency banks, Refund of excess pension payment to the Government, Withdrawal of pension by old/ sick/ disabled/ incapacitated pensioners, Reimbursement of pension payments, Continuation of either or survivor pension account after the death of a pensioner, Life Certificate-Issuance of Acknowledgement, Single Window System for reimbursement of Pension Payments and Customer Service.

It impacts all Agency Banks.

Master Circular on SHG-Bank Linkage Programme

RBI has issued a Master Circular on the SHG-Bank Linkage Programme, dated 1 April 2024. The circular consolidates guidelines and instructions issued by RBI on the subject up to 31 March 2024, providing banks with comprehensive guidance in one document.

The Master circular includes general instructions on the Opening of Savings Bank A/C, Lending to SHGs, Interest rates, Service/ Processing charges, Separate Segment under the priority sector, Presence of defaulters in SHGs, Capacity Building and Training, Monitoring and Review of SHG Lending and Reporting to CICs.

The circular impacts all Scheduled Commercial Banks.

Master Circular - Guarantees And Co-acceptances

RBI has issued a Master Circular on Guarantees and Co-acceptances, dated 1 April 2024. It consolidates instructions issued to banks on the subject up to 31 March 2024, updating the previous circular from 31 March 2023. This circular serves as a comprehensive guide for banks regarding guarantees and co-acceptances.

The circular impacts all Scheduled Commercial Banks excluding payment banks and RRBs.

Master Circular - Lead Bank Scheme

RBI has issued a Master Circular on the Lead Bank Scheme, dated 1 April 2024. It consolidates guidelines and instructions issued by RBI on the Lead Bank Scheme up to 31 March 2024, listed in Appendix I of the circular.

The circular impacts SLBC, UTLBC Convenor Banks and Lead Banks

Master Circular On Board Of Directors - UCBs

RBI has issued a Master Circular on the Board of Directors - UCBs, dated 1 April 2024. It consolidates and updates all instructions and guidelines on the subject issued by RBI until the present date.

The circular applies to all Primary (Urban) Co-operative Banks

Master Circular - Prudential Norms On Capital Adequacy - Primary (Urban) Co-operative Banks (UCBs)

RBI has issued Master Circular - Prudential Norms on Capital Adequacy - Primary (Urban) Co-operative Banks (UCBs), dated 1 April 2024.

The Master Circular consolidates and updates all instructions and guidelines up to 31 March 2024.

The circular applies to all Primary (Urban) Co-operative Banks

Master Circular - Prudential Norms On Income Recognition, Asset Classification And Provisioning Pertaining To Advances

RBI has issued Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances, dated 2 April 2024. This revised master circular consolidates instructions and guidelines issued to banks issued up to 31 March 2024, relating to Housing Finance and does not contain any new instructions/guidelines.

The circular applies to all Commercial Banks excluding RRBs.

Master Circular - Income Recognition, Asset Classification, Provisioning And Other Related Matters - UCBs

RBI has issued a Master Circular - Income Recognition, Asset Classification, Provisioning and Other Related Matters - UCBs, dated 2 April 2024. The revised Master Circular, updated to reflect all instructions issued up to 31 March 2024 does not contain any new instructions/guidelines.

The circular applies to all Primary (Urban) Co-operative Banks

Dealing In Rupee Interest Rate Derivative Products - Small Finance Banks

RBI has issued a notification on Dealing in Rupee Interest Rate Derivative products - Small Finance Banks, dated 23 April 2024.

The existing guidelines permit Small Finance Banks (SFBs) to use only Interest Rate Futures (IRFs) for the purpose of proprietary hedging.

SFBs are now permitted to deal in permissible rupee interest rate derivative products for hedging interest rate risk in terms of the Rupee Interest Rate Derivatives (Reserve Bank) Directions, 2019 dated 26 June 2019, in order to expand the avenues available to the SFBs for hedging interest rate risk in their balance sheet and commercial operations more effectively as well as with a view to provide them with greater flexibility.

These instructions shall come into force with immediate effect.

The circular applies to All Small Finance Banks

Foreign Exchange Management (Mode Of Payment And Reporting Of Non-debt Instruments) (Amendment) Regulations, 2024

RBI has issued an amendment to Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) Regulations, 2019, dated 23 April 2024. These Regulations may be called the Foreign Exchange Management (Mode of Payment and Reporting of Non-Debt Instruments) (Amendment) Regulations, 2024.

Regulation 3.1 of the Principal Regulations has been amended to insert Schedule XI which has the following 2 (two) aspects:

Mode of Payment: The amount of consideration for the purchase/ subscription of equity shares of an Indian company listed on an International Exchange will be paid either through banking channels to a foreign currency account of the Indian company held as per Foreign Exchange Management (Foreign currency accounts by a person resident in India) Regulations, 2015 or as inward remittance from abroad through banking channels.

Remittance of Sale Proceeds: The sale proceeds (net of taxes) of the equity shares may be remitted outside India or may be credited to the bank account of the permissible holder maintained in accordance with the Foreign Exchange Management (Deposit) Regulations, 2016.

Regulation 4 of the Principal Regulations: the authorised dealer category I banks (AD Bank) will report to the RBI in Form LEC (FII) the purchase/ transfer of equity instruments by FPIs on the stock exchanges in India; and the Investee Indian company through an AD Bank is required to report to the RBI in Form LEC (FII) the purchase/subscription of equity shares (where such purchase/ subscription is classified as FPI under the rules) by permissible holder, other than transfers between permissible holders, on an International Exchange.

They shall come into force from the date of their publication in the Official Gazette.

The circular applies to all Listed Companies and All Authorised Dealer Category 1 Banks

Foreign Exchange Management (Foreign Currency Accounts By A Person Resident In India) (Amendment) Regulations, 2024

RBI has issued an amendment to Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) Regulations, 2015, dated 23 April 2024. These Regulations may be called the Foreign Exchange Management (Foreign Currency Accounts by a person resident in India) (Amendment) Regulations, 2024.

Regulation 5 of the Principal Regulations:

In sub-regulation (F)(1) of Regulation 5 of the Principal Regulations, the existing provision shall be substituted by "Subject to compliance with the conditions in regard to raising of External Commercial Borrowings (ECB) or raising of resources through American Depository Receipts (ADRs) or Global Depository Receipts (GDRs) or through direct listing of equity shares of companies incorporated in India on International Exchanges, the funds so raised may, pending their utilisation or repatriation to India, be held in foreign currency accounts with a bank outside India."

They shall come into force from the date of their publication in the Official Gazette.

The circular applies to all Listed Companies

Master Direction – Reserve Bank Of India (Asset Reconstruction Companies) Directions, 2024

RBI has issued a Master Direction on Reserve Bank of India (Asset Reconstruction Companies) Directions, 2024, dated 24 April 2024. These directions are aimed at ensuring the prudent and efficient functioning of Asset Reconstruction Companies (ARCs) to protect the interest of investors.

These Directions have been issued in the exercise of the powers conferred by Sections 3, 9, 10, 12 and 12A of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (54 of 2002).

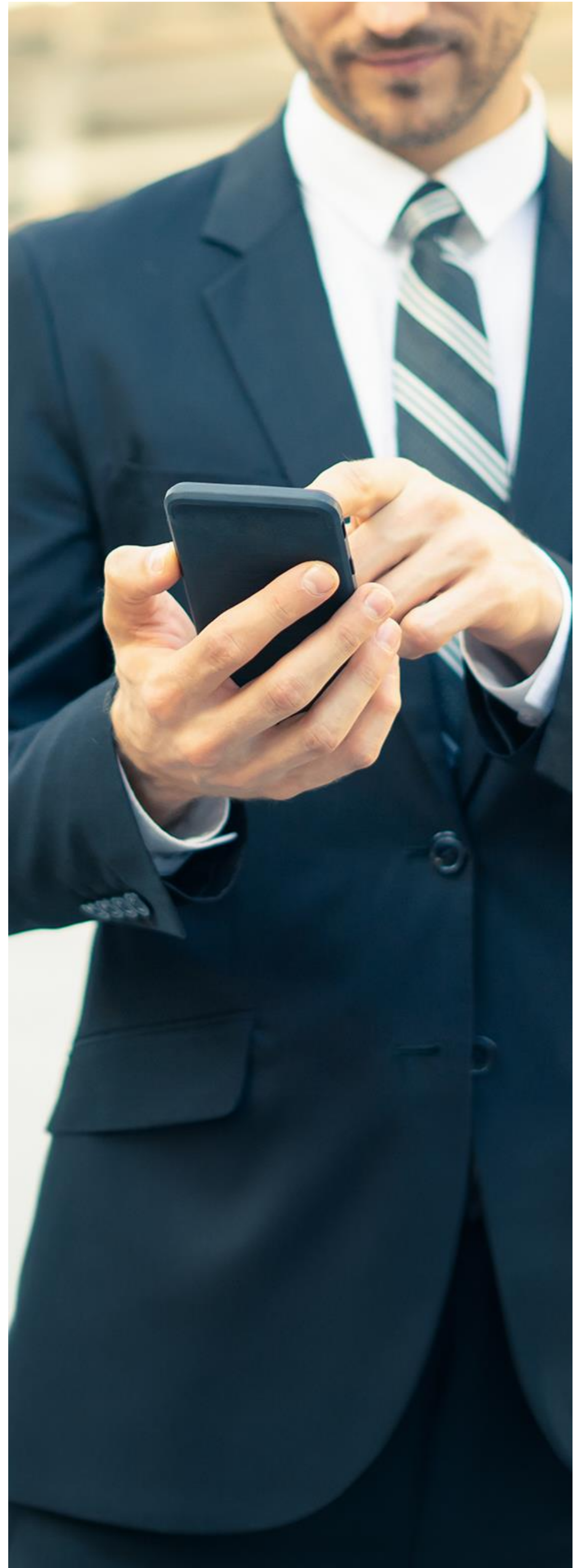
The circular applies to all Asset Reconstruction Companies (ARCs)

Master Circular - Bank Finance to Non-Banking Financial Companies (NBFCs)

RBI has issued a Master Circular on Bank Finance to Non-Banking Financial Companies (NBFCs), dated 24 April 2024. The circular consolidates all instructions issued up to 23 April 2024, without introducing any new guidelines. It serves to update the previously issued Master Circular.

The Master Circular includes Terminology, Background, Bank Finance to NBFCs registered with RBI, Bank Finance to NBFCs not requiring Registration, Activities not eligible for Bank Credit, Leased and Sub-Leased Assets, Bank Finance to Factoring Companies, Other Prohibitions on Bank Finance to NBFCs, Prudential ceilings for exposure of banks to NBFCs, Restrictions regarding investments made by banks in securities/ instruments issued by NBFCs and Risk weights for bank credit to NBFCs.

The circular applies to all Scheduled Commercial Banks (excluding RRBs)



REGULATORY UPDATES

Framework For Category I And II Alternative Investment Funds (AIFs) To Create An Encumbrance On Their Holding Of Equity Of Investee Companies

The framework for the creation of an encumbrance on the equity of the investee company has now been notified by SEBI.

- Creation of Encumbrance by AIFs: AIFs falling under Category I or Category II, which haven't onboarded any investors before 25 April 2024, can create encumbrances on the equity of investee companies for borrowing purposes, provided explicit disclosure is made in their Private Placement Memorandums (PPMs).
- Continuation of Existing Encumbrances:
  - Existing encumbrances created by Category I or Category II AIFs before 25 April 2024, can continue if disclosed in the PPM.
  - If encumbrances were created without disclosure, continuation is subject to obtaining consent from all investors by 24 October 2024. If the Consent of all investors is not obtained within the aforesaid period, the encumbrances shall be removed by 24 January 2025.
  - Encumbrances created without disclosure on securities other than specified must be removed by 24 October 2024.
- Utilisation of Borrowings against encumbered equity investments should be utilised only for the development, operation, or management of the investee company, as per specified purposes in the brief section.
- Duration of Encumbrance: The duration of encumbrance should not exceed the residual tenure of the AIF scheme.

Voluntary Transition Of Small Finance Banks To Universal Banks

The Reserve Bank of India (RBI) has detailed a transition path for Small Finance Banks (SFBs) seeking to convert into Universal Banks.

The guidelines from the RBI set clear eligibility criteria for SFBs that wish to transition to Universal Banks such as track record, net worth, listing on stock exchanges, capital adequacy, Profitability, and asset quality. Specific conditions regarding shareholding patterns and promoters during the transition have also been prescribed. Eligible SFBs must submit their application to the RBI's Department of Regulation in Mumbai, with a detailed rationale for their transition. Once transitioned, the bank will adhere to all relevant norms, including the Non-Operative Financial Holding Company (NOFHC) structure.

Flexibility To Alternative Investment Funds (AIFs) And Their Investors To Deal With Unliquidated Investments Of Their Schemes

During the 'liquidation period', an AIF can distribute investments of a scheme which are unsold due to lack of liquidity, in-specie to the investors, or enter the dissolution period, after obtaining approval of at least 75% of the investors by value of their investment in the AIF scheme subject to the satisfaction of conditions prescribed in the Circular. The Circular also prescribes a mandatory in-specie distribution if, during the liquidation period, the requisite investor consent is not obtained for: (a) entering the dissolution period; or (b) in-specie distribution. In case any investor is not willing to take in-specie distribution, such investment is to be written off. As a measure of providing one-time flexibility to certain AIFs, the SEBI has

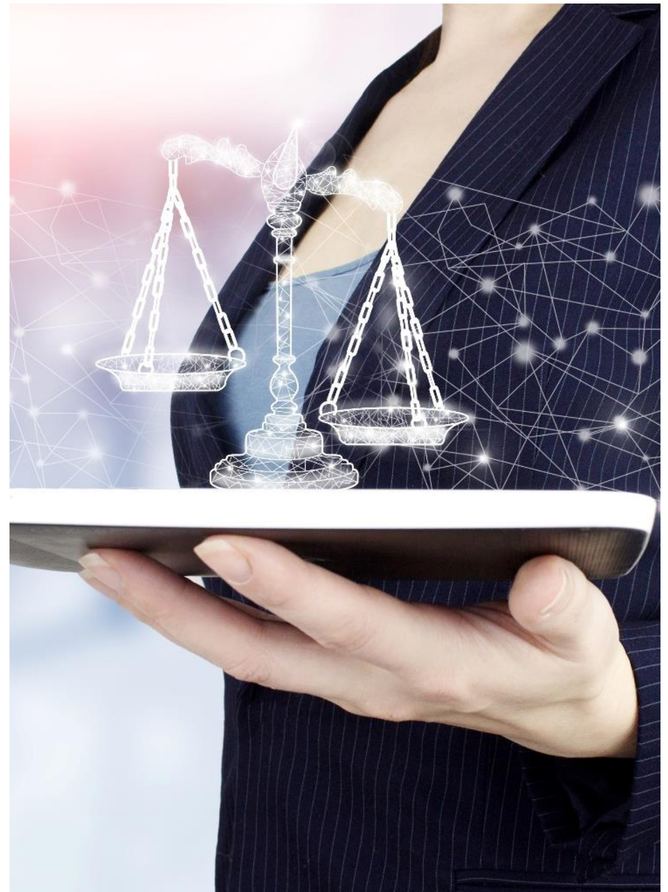
allowed an extension of the liquidation period till 24 April 2025, in cases where the liquidation period for an AIF scheme has expired or is expiring by 24 July 2024, and if such AIF scheme does not have any pending investor complaint on non-receipt of funds/securities as on 25 April 2024.

Relaxation In Requirement Of Intimation Of Changes In The Terms Of Private Placement Memorandum Of Alternative Investment Funds Through Merchant Banker

The SEBI, in order to facilitate ease of doing business and rationalise the cost of compliance for AIFs, vide its circular dated 29 April 2024, relaxed compliance relating to an intimation of change in terms of the Private Placement Memorandum (PPM).

Earlier any change in PPM was required to be submitted through a merchant banker along with a due diligence certificate in a prescribed format. As per the aforementioned circular, specified changes in PPM may be filed directly with SEBI, instead of submission through a merchant banker.

Further, Large Value Fund for Accredited Investors (LVFs) may directly file any change in the terms of PPM with SEBI instead of submitting through a merchant banker. Filing with SEBI is to be accompanied by a duly signed and stamped undertaking by the CEO (or a person holding an equivalent position) and Compliance Officer of the Manager of the AIF, in a specified format.



DIRECT TAX

CIRCULARS / NOTIFICATIONS / PRESS RELEASE

CBDT Has Enabled Functionalities To File Income Tax Returns For Fiscal Year 2023-24

For facilitating the taxpayers to file their Income Tax Returns (ITRs) for the Fiscal Year (FY) 2023-24, CBDT has enabled the functionality of filing the ITR-1, ITR-2, ITR-4 and ITR-6 on the e-filing portal from 1 April 2024. Further, to facilitate the e-Return Intermediaries (ERIs), the JSON Schema for ITR-1, ITR-2, ITR-4 and ITR-6 and Schema of Tax Audit Reports have also been made available for FY 2023-24. The same can be accessed under the downloads section of the e-filing portal. Facility to file ITRs 3, 5 and 7 will be made available shortly.

[Press Release, dated 4 April 2024]

CBDT Clarifies Media Reports Claiming A Special Drive To Reopen Cases With Reference To The House Rent Allowance (HRA) Claim

The Tax Authorities have noticed certain instances of mismatch of information (relating to HRA claim and rent paid) as filed by the taxpayer and as available with the Tax Authorities. Hence, the Tax Authorities alerted the taxpayers to take corrective measures. Some social media posts and media articles have highlighted enquiries initiated by the CBDT in cases where the employees have made incorrect claims of House Rent Allowance (HRA) and rent paid.

In this regard, CBDT has issued a press release that the objective of the e-verification was to alert cases of mismatches of information for FY 2020-21 only without affecting the others. It also reiterated that there is no special drive to re-open such cases, and media reports

alleging that large-scale re-opening is being undertaken by the Tax Authorities are completely misplaced.

[Press Release, dated 8 April 2024]

CBDT Specifies Certain Forms To Be Furnished Electronically

Pursuant to the power conferred under Rule 131[1] of the Income Tax Rules, 1962 (IT Rules), the Directorate of Income Tax (Systems), with the approval of the Central Board of Taxes (CBDT), has notified that the following forms shall be furnished and verified electronically.

Sr. No.	Form	Description
1	3CED	Application for an Advance Pricing Agreement (APA)
2	3CED	Application for withdrawal of APA request

[1] Rule 131 of the IT Rules grants power to Principal Director General of Income-tax (Systems) or the Director General of Income-tax (Systems), to specify any of the Forms, returns, statements, reports, orders, etc to be furnished electronically under digital signature or through electronic verification code.

Sr. No.	Form	Description
3	3CEFA	Application for Opting for Safe Harbour
4	3CT	Income attributable to assets located in India under section 9 of the Income Tax Act, 1961 (IT Act)
5	10BBA	Application for notification under sub-clause (iv)[2] of clause (c) of Explanation 1 to the section 10(23FE) of the IT Act
6	10BBC	Certificate of accountant in respect of compliance to the provisions of section 10(23FE) of the IT Act by the notified Pension Fund
7	10FA	Application for Certificate of residence for the purposes of an agreement under sections 90 and 90A of the IT Act (i.e. Application for Tax Residency Certificate)
8	34F	Form of application for a taxpayer, resident in India, seeking to invoke mutual agreement procedure provided for in agreements with other countries or specified territories

This notification shall be effective from 1 April 2024.

[Notification No. 01/2024, dated 26 February 2024]

CBDT Relaxes Consequences Of Non-linking Of Permanent Account Number (PAN) And Aadhar If The Same Is Linked By 31 May 2024 For Transactions Up To 31 March 2024

Ministry of Finance through its notification has notified the list of goods on which derivatives can be launched. The list of additional goods is as follows:

The CBDT vide Circular No 3 of 2023 dated 28 August 2023 had clarified the consequences that an individual taxpayer would face on failure to intimate the Aadhar number in accordance with section 139AA[3] of the IT Act read with Rule 114AAA[4] of the IT Rules. One such consequence was tax withholding/ tax collection at a higher rate under sections 206AA[5] and 206CC8 of the IT Act. As a result, the deductors received notices for short withholding/ collection of tax where the PAN of the deductees/ collectees were made inoperative.

With a view to address the grievances faced by such deductors/ collectors, the CBDT in continuation of circular no 3 of 2023 has specified that for the transactions entered up to 31 March 2024 and in cases where the PAN becomes operative as a result of linking it with Aadhar on or before 31 May 2024, there shall be no liability on the deductor/ collector to withheld or collect the tax at higher rates as prescribed under section 206AA and 206CC of the IT Act.

[Circular No. 6/2024, dated 23 April 2024]

The Government Of India And The Government Of Mauritius Signs The Protocol Amending The India-mauritius Double Taxation Avoidance Agreement

The Government of India and the Government of Mauritius signed a protocol on 7 March 2024 to amend the India-Mauritius Double Taxation Avoidance Agreement ('DTAA' or 'treaty'). The following changes have been proposed by the protocol:

- The existing preamble to India-Mauritius DTAA is to be replaced to provide that the purpose of the treaty is to eliminate double taxation with respect to taxes covered by this treaty without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this treaty for the indirect benefit of residents of third jurisdictions).
- Incorporation of Principle Purpose Test (PPT) wherein a benefit under this treaty shall not be granted in respect of an item of income if it is reasonable to conclude that one of the principal purposes of the arrangement or transaction is to directly or indirectly take benefit of the treaty unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of this treaty.

This protocol shall be effective from the date of the latter of the two notifications. Currently, the protocol is not effective as the Notification is yet to be issued.

The provisions of the protocol shall have effect from the date of entry into force, without regard to the date on which the taxes are levied or the taxable years to which the taxes relate.

Further, the Department on its X handle (erstwhile Twitter) has clarified that the Protocol is yet to be ratified and notified under Section 90 of the IT Act. Further, the document is revoked from the Ministry of External Affairs (MEA)'s website after a few days of its upload.

[3] Section 139AA of the IT Act provides that if the PAN and Aadhar is not linked before the specified date then the PAN shall be treated as inoperative.
[4] Rule 114AAA of the IT Rules provides for the consequences on PAN becoming inoperative. It also provides timeline within which PAN will be made operative and fees for making it operative.
[5] Section 206AA of the IT Act and section 206CC of the IT Act provides for higher tax withholding / tax collection if valid PAN is not furnished.

JUDICIAL UPDATES

Madras High Court Holds That Failure To Request For Personal Hearing Through A Prescribed Mode Does Not Constitute A Fatal Flaw

For FY 2017-18, a notice was issued to the taxpayer, a private limited company, proposing to complete the assessment as per the draft assessment order. In response to the said notice, the taxpayer submitted the relevant information and documents and requested for virtual hearing through the National Faceless Assessment Centre (NaFAC).

The taxpayer was requested to make an application for a hearing through video conference within seven days of receipt of the said communication. The taxpayer responded through a letter addressed to the Additional or Joint or Deputy or Assistant Commissioner of Income Tax, National e-Assessment Centre, Delhi stating that though he attempted to log in for applying for personal hearing through video conference, there was some problem with the web portal, and he was unable to apply online. Thereafter, the taxpayer was directed to apply through NaFAC for a virtual hearing, but he reiterated his request for a personal hearing through video conference.

NaFAC communicated that as the taxpayer had neither clicked on "Taxpayer Request", nor filled up the box of agenda of video conference, no personal hearing through video conference was extended. The taxpayer was once again requested to click on the "Taxpayer Request" and seek a personal hearing, failing which it would be considered that video conference was not required. The taxpayer replied that despite trying to log in to apply for a personal hearing they were unable to apply online. Also, the taxpayer vide email addressed to 'efilingwebmanager@incometax.gov.in' stated that there was no option of "Box of agenda of VC". The final order was passed without a personal hearing.

Aggrieved by the order, the taxpayer filed a writ petition before the Madras HC. The Madras HC set aside the assessment order and directed to pass the order after providing the taxpayer with a reasonable opportunity for a personal hearing through video conference. While setting aside the said order, the Madras HC followed the below observation made in its earlier decision:

- Mere failure on the part of the taxpayer to click on the request button does not by itself indicate that a personal hearing is not required.
- Where the taxpayer had specifically sought an opportunity for a personal hearing via the written submissions and no opportunity was granted, it constitutes a violation.
- An opportunity of hearing sought by the taxpayer in the written submissions constitutes a legitimate request and that cannot be brushed aside by the tax authorities.
- Failure to click on the "Taxpayer Request" and the Box for video conference does not amount to a fatal flaw.

[Bay-Forge Private Limited v. ITO / NFAC, W.P.No. 24422 of 2021 (Madras High Court]

Jammu & Kashmir High Court Holds That The Company's Leasehold Land Is To Be Included In Computing The Fair Market Value Of Its Share

The taxpayer, an individual, along with his wife and two sons, owned 21,000 shares of Jyoti Private Limited (Company). During FY 1997-98, the taxpayer transferred 7,150 shares of the Company to Bharat Hotels Limited, New Delhi for a consideration of INR 100 million. For computing capital gains, the taxpayer applied indexation to the value as of 1 April 1981 and thereby calculated capital loss. In the tax return filed, the taxpayer appended a note to the computation of income stating that he had sold his shares in the Company and, as per the valuation of the company's assets, there was a capital loss, which was not being claimed.

The tax officer did not agree with the indexed cost computed by the taxpayer and re-computed it by excluding the fair market value of the leasehold land and thereby worked out capital gains in the hands of the taxpayer.

The First Appellate Authority deleted the additions made by the tax officer, which was confirmed by the Delhi Tax Tribunal. Aggrieved, the tax officer filed an appeal before the Hon'ble Jammu and Kashmir (J&K HC). The J&K HC while dismissing the appeal made the following observations:

- On the date of the transfer of shares by the taxpayer, the Company owned one hotel building along with leasehold interest on the land on which said hotel building stood.
- The land measuring 225 kanals 17 Marlas over which the building stood, was acquired by the Company from its owner Shri Vikramaditya Singh *vide* Lease Deed dated 21 March 1973 for a period of 40 years.
- Due to the restrictions then prevailing in the State of Jammu & Kashmir, a Company being a non-state subject was prevented from owning land in the State.
- The tax officer proceeded to determine the FMV of the shares transferred on the basis of the break-up method, i.e., by adopting the FMV of the hotel building as per the report of the approved valuer to be divided by the number of shares held by the taxpayer and other shareholders.
- The taxpayer, on the other hand, computed the FMV of the asset of the company as per the report of the registered valuer and accordingly, the average FMV of each share was computed.
- The tax officer excluded the value of the land while arriving at the FMV of shares on the ground that the said land was owned by Vikramaditya Singh but did not include the same while making the assessment in his case. Such action is apparently erroneous and unsustainable in law.
- As of the date of sale of shares, the lease period of beyond 20 years was still left with the Company. Hence, the land value in the hand of the lessor was practically nil and for all practical purposes, the Company was the de facto owner of the underlying land. Therefore, the value of leasehold land cannot be excluded from calculating the FMV of shares of the Company.

- It is the FMV, and not book value, of an asset which is relevant for determining the cost of acquisition as envisaged under Section 55(2)(b)(ii) of the IT Act for determining capital gain under Section 45 of the IT Act.
- The leasehold interest in the land is an asset of the Company and is capable of valuation as such the same is to be included in the value of an asset of the Company so as to determine the FMV of shares held by the taxpayer as well as other shareholders.

[PCIT v. Dr. Karan Singh, ITA No.1/2022 (Jammu & Kashmir High Court)]

Delhi High Court Holds That Valuation Under Section 56(2)(viib) Of The IT Act Cannot Be Rejected Basis Of Inconsistency Between Projected And Actual Figures

The taxpayer, a private limited company, issued equity shares having a face value of INR 10 per share at a premium of INR 40 per share. The premium was determined based on the Discounted Cash Flow (DCF) method adopted by a Merchant Banker. The tax officer contended that the valuation was based on the unverified exorbitant forecast given by the management of the taxpayer and hence replaced the project figures with the actual figures. Consequently, the tax officer computed FMV and thereby brought the premium in excess of FMV to tax under section 56(2)(viib)[6] of the IT Act. The said addition was confirmed by the First Appellate Authority. The Delhi Tax Tribunal granted the relief to taxpayers. On appeal before the Delhi High Court (Delhi HC), the Delhi HC remanded the matter back to the tax officer for undertaking a fresh valuation. While remanding back, it made the following observations:

- The Delhi Tax Tribunal[7] has rightly come to conclude that actual figures could not have been taken into consideration for the purposes of Section 56(2)(viib) of the IT Act.
- Reliance was placed on the Delhi HC's ruling in Cinestaan Entertainment Pvt. Ltd[8] wherein the Delhi Tax Tribunal observed that Section 56(2)(viib) of the IT Act is a deeming provision and one cannot expand the meaning of the scope of any word while interpreting such deeming provision. If the statute provides that the valuation has to be done as per the prescribed method and if one of the prescribed methods has been adopted by the taxpayer, then the tax officer has to accept the same and in case he is not satisfied, then there is no express provision under the IT Act or IT rules, where the tax officer can adopt his valuation in DCF method or get it valued by some different valuer.
- Factors based on which projections are made cannot be evaluated purely based on arithmetical precision as value is always worked out based on approximation and assumptions. When valuation is made, it is based on reflections of the potential value of a business at that time and keeping in mind underlying factors that may change over the period of time thus, the value which is relevant today may not be relevant after a certain period of time. These factors have been judicially appreciated in various judgments which are relied upon by the taxpayer.
- An estimation would, to some extent, be based on an approximate evaluation. That estimation would not be liable to be questioned based on facts or figures. Ultimately, the correctness of an estimation would have to be tested based on a legitimate and valid assessment.

[PCIT v. Abhirvey Projects Private Limited (ITA 618/2023, CM No. 58381/2023) (Delhi High Court)]

Delhi Tax Tribunal Holds That Treaty Benefit On Salary Is Allowed On The Basis Of Tax Compliance In The Contracting State If TRC Is Not Furnished

The taxpayer, an individual, is an employee of Nokia India. He was placed on an overseas assignment in Australia with Nokia Australia from 23 August 2017 to 10 March 2020. During FY 2019-20, the taxpayer was physically present in Australia and was in India for less than 60 days. He qualified as a Non-Resident in India as per Section 6(1) of the IT Act. Further, for the Australian tax year[9] (TY) 2018-19 and 2019-20, the taxpayer qualified as a Resident of Australia under the domestic tax law of Australia. For FY 2019-20, the taxpayer qualified as a resident of Australia as per Article 4(1)[10] of the India-Australia Double Taxation Avoidance Agreement (DTAA).

The salary was paid to the taxpayer in India for administrative convenience and the payroll remained in India while he was on an assignment in Australia.

In terms of Article 15(1)[11] 'Dependent Personal Services' of the India-Australia DTAA, the taxpayer claimed exemption for salary received from services rendered in Australia. To support its exemption claim, the taxpayer submitted his passport and Australia Tax returns for TY 2018 and 2019 evidencing residency in Australia and proof of payment of taxes in Australia. In the draft order, the tax officer denied the exemption on the premise that the taxpayer had not submitted the Tax Residency Certificate (TRC) issued by Australian tax authorities. The taxpayer filed his objections with the Dispute Resolution Panel (DRP) and submitted the TRC as additional evidence. However, DRP upheld the tax officer's draft order and hence the tax officer passed the final order taxing the salary in India. Aggrieved, the taxpayer filed an appeal before the Delhi Tax Tribunal.

The Delhi Tax Tribunal, while ruling in favour of the taxpayer, made the following observations:

- The following conditions are required to be satisfied to claim exemption under Article 15(1) of the India-Australia DTAA:
  - The person should be a Resident of Australia; and
  - The salary and other remuneration should be earned in respect of employment exercised in Australia.
- Reliance is placed on Delhi Tax Tribunal's ruling in the case of Vishal Gulati[12] wherein it was held that where a non-resident taxpayer had rendered services outside India and the taxpayer neither had any rest period nor leave period which was preceded and succeeded by services rendered outside India, salary received by the taxpayer from an Indian company could not be taxed in India.

[6] Section 56(2)(viib) of the IT Act provides that where a closely held company issues shares at premium and the issue price is more than the FMV, excess of premium shall be taxable in the hands of issuer company as Income from Other Sources.
[7] Abhirvey Projects Pvt. Ltd v. ACIT (ITA No. 9400/DEL/2019)
[8] Pr.CIT vs. Cinestaan Entertainment Pvt. Ltd. (ITA No.1007/2019)
[9] Australian Tax Year means the calendar year beginning from 1 July and ending on 30 June.
[10] Article 4(1) of India-Australia DTAA provides the criteria as to who shall be considered a resident.
[11] Article 15(1) of India-Australia DTAA grants taxing rights on income from salaries, wages and similar remuneration to the resident country unless employment is exercised in the Source Country.
[12] Vishal Gulati vs. ACIT [2024] 159 Taxmann.com 713

- Similarly, the Delhi Tax Tribunal in the case of Anjali Puri[13] held that where the taxpayer was residing and exercising employment in Ireland under complete control of BA PLC, Ireland for the impugned fiscal year and services were rendered in Ireland, and salary was also borne by BA PLC, Ireland, salary of taxpayer though derived from BA PLC, India on behalf of BA PLC, Ireland could not be said to be deemed to accrue or arise in India and was duly exempt from tax in India.
- The tax officer denied the exemption claimed under Article 15(1) of the India- Australia DTAA on the premise that the TRC was not furnished while ignoring that alternate evidence in support of the Tax Residency in Australia has been duly furnished i.e., Australian tax return is evidence of residency in Australia and evidences due payment of taxes in Australia. The taxpayer applied for TRC in Australia for the TY 2018 and TY 2019, and it is pertinent to highlight that the taxpayer had received the TRC of Australia issued by the Australia Taxation Office for TY 2019-20 and in this regard, an application for admission of additional evidence was filed before the DRP.
- As per the provision of Section 9(1)(ii) of the IT Act, the income earned under the head "Salaries" is taxable in India "if it is earned" in India. The explanation issued for the removal of doubts declares that 'salaries if it is earned' meet services rendered in India.
- The taxpayer neither had any rest period nor leave period which is preceded and succeeded by the services rendered outside India. Since the taxpayer rendered services outside India, the salary cannot be taxable in India.

  [Yogesh Kotiyal v. ACIT (ITA No. 391/Del/2023) (Delhi Tax Tribunal]

Delhi Tax Tribunal Holds That Safe Harbour Provision For Share Premium Is Effective Retrospectively

CBDT had issued Notification No. 81/2023 dated 25 September 2023 amending Rule 11UA of the IT Rules. It provided different valuation methods for valuing shares. The amended Rule also contains a tolerance band as per which if the difference between actual consideration and the FMV of the shares does not exceed 10%, then the actual consideration shall be deemed to be the FMV. Recently, the Delhi Tax Tribunal has held that the curative amendment in Rule 11UA of the IT Rules introduced by the Notification 81/2023 will apply retrospectively. To read our detailed analysis, please go to https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-delhi-tax-tribunal-holds-that-safe-harbour-provision-for-share-premium-is-effective

(Sakshi Fincap Pvt. Ltd. v. ITO [ITA No. 8389/Del/2019] (Delhi Tax Tribunal]

[13] Anjali Puri vs. ACIT [2024] 159 Taxmann.com 603

INDIRECT TAX

Personal Hearing Opportunity Cannot Be Scheduled Before The Due Date For Filing The Reply To The Show Cause Notice

Facts of the case

- Mahindra & Mahindra Limited (Taxpayer) is a registered taxpayer under the Central Goods and Services Tax Act, 2017 (CGST Act).
- The Taxpayer had received a Show Cause Notice (SCN) under Section 73(1) of the CGST Act for a contemplated tax demand on 29 September 2023. Further, the SCN indicated that the due date to file a reply to the SCN was 30 October 2023 whereas a personal hearing was scheduled on 12 October 2023 which was subsequently re-scheduled on 25 October 2023. However, the Taxpayer could not appear on the designated dates and an adjournment was sought by the Taxpayer.
- Subsequently, on 15 November 2023, the Taxpayer filed a reply to SCN and also requested the tax authorities to provide a personal hearing opportunity.
- Thereafter, on 29 December 2023, the tax authorities issued the Order-in-Original without providing a personal hearing opportunity to the Taxpayer.
- Against this, the Taxpayer challenged the validity of the Order-in-Original before the Chhattisgarh High Court under Article 226 of the Constitution of India (Constitution) on the ground that the order had been issued in violation of the principles of natural justice. However, the High Court *vide* the Impugned Order, dismissed the Writ Petition on the grounds of availability of alternate remedy.
- Aggrieved by the above, the Taxpayer filed an appeal before the Chhattisgarh High Court.

Contentions of the Taxpayer

- The GST law mandates the tax authorities to undertake the following actions before imposing a liability on the Taxpayer:
  - Section 73(9) of the Central Goods and Services Tax Act, 2017 (CGST Act) contemplates that the officer shall issue an order after considering the representation made by the Taxpayer; and
  - Section 75(4) of the CGST Act mandates the tax authorities to provide a personal hearing opportunity if sufficient cause is shown and where an adverse decision is contemplated against the Taxpayer.
- In the present case, an adverse order was issued without providing an opportunity to be heard and hence, the principles of natural justice were violated.
- Reliance in this regard was placed on Kalpraj Dharamshi and Anr. Vs. Kotak Investment Advisors Ltd. [2021 (10) SCC 401] wherein it was held that in cases where the principles of natural justice have been given a go-by, the party can invoke the jurisdiction under Article 226 of the Constitution. Hence, the Impugned Order is bad in law.
- Further, the provisions of Section 75(5) of the CGST Act which mandates the tax authorities to provide three hearings to the Taxpayer during the proceedings was not adhered to.

Contentions of the Tax Authority

- Section 75(4) of the CGST Act does not contemplate the personal hearing opportunity to be given at every stage.

- Further, the Order-in-Original stipulates that while personal hearing opportunities were provided to the Taxpayer on 11 October 2023 and 25 October 2023, the Taxpayer failed to appear. Thus, Section 75(4) of the CGST Act has not been violated.
- Even otherwise, the High Court, vide the Impugned Order had only delegated the Taxpayer to file an appeal and the Writ Petition before the High Court was filed by the Taxpayer to avoid the filing of an appeal (and consequently, avoid payment of pre-deposit) before the appellate authority.

Observations and Ruling by the High Court

- Section 73(9) of the CGST Act mandates the tax authorities to consider the representation filed by the Taxpayer (if any) before issuing an order. Section 75(4) of the CGST Act contemplates that an opportunity for a hearing is granted to the Taxpayer when a request is received in writing whereas Section 75(5) of the CGST Act enables a Taxpayer to obtain adjournments (with a maximum capping of three adjournments).
- The contention of the tax authorities that since the hearing opportunities were already provided to the Taxpayer on 11 October 2023 and 25 October 2023, the mandate provided under Section 75(4) of the CGST Act stands satisfied is not correct on account of the following:
  - Since the opportunity of hearing is contemplated under the statute, the same has to be comprehensive and it cannot be short-circuited.
  - The SCN reflects that the reply to SCN was due to be filed by 30 October 2023 whereas the personal hearing was provided before such date. Such a personal hearing opportunity would be superfluous and would defeat the actual intent of the legislation because a Taxpayer cannot be heard before the reply is filed.
  - Providing a personal hearing opportunity before the filing of a reply is against the normal procedure as well as the normal practice of the parties.
- The Supreme Court ***in Umanath Pandey Vs. State of UP [2009] 12 SCC 40-43]*** has held that the opportunity of hearing means granting real and meaningful opportunity and adequate time must be given to prepare and present the defence.
- Oral hearing has its eminence in the adjudication process and is recognised as an important aspect of adjudication not only in India but across several jurisdictions.
- It is well settled that the officials taking action of a judicial nature must give an adequate opportunity to be heard to a person against whom action is proposed to be taken. This would ensure fairness of procedure in the dealings between the public authorities and the citizens and thereby promote fair play in such dealings. When the statute specifically provides for the process of personal hearing, the Courts are duty-bound to uphold such procedure and ensure that a meaningful opportunity is provided.
- In view of the above, it was held that since the GST law contains a mandate of hearing, the same cannot be given a go by, or made porous and hence, the Impugned Order is not correct and hence, set aside.

  [Mahindra & Mahindra Limited Vs. Union of India & Ors. [TS-242-HC(CHAT)-2024-GST], dated 30 April 2024]

Bona Fide Buyers Shall Not Be Penalised Before Causing Enquiry With The Supplier For Non-remittance Of Tax

Facts of the case

- Lokenath Construction Pvt. Ltd. (Taxpayer) is a registered taxpayer under the CGST Act.
- The Taxpayer had received a SCN dated 22 August 2023 from the tax authorities alleging that the Taxpayer had failed to produce any evidence to substantiate that the suppliers had paid GST to the Government on those supplies (which are disclosed/ admitted by the suppliers in its Form GSTR-1 returns) and that the Taxpayer had availed and utilised input tax credit (ITC) in contravention to Section 16(2)(c) of the CGST Act.
- The Taxpayer had challenged the aforesaid SCN before the Calcutta High Court on the ground that the SCN sought to deny ITC to the Taxpayer without causing any verification from the supplier's end.
- However, the aforesaid Writ Petition was disposed of by the High Court and the Taxpayer was directed to file an objection to the SCN and the Tax Authorities were directed to consider the same and take note of the judgement relied upon by the Taxpayer. Against this, the Taxpayer filed an intra-court appeal before the Calcutta High Court.
- During the pendency of the aforesaid appeal, the tax authorities vide the Impugned Order-in-Original dated 28 December 2023 had confirmed the demand made in the aforesaid SCN. Against this, the Taxpayer filed a Writ Petition before the Calcutta High Court.

Contentions of the Taxpayer

- In the Writ Petition, the Taxpayer had inter alia contended that the SCN is without jurisdiction, more particularly in light of the decision in ***Suncraft Energy Pvt. Ltd. Vs. Assistant Commissioner of State Tax [2023 (9) Centax 48 (Cal.)] (affirmed by the Supreme Court in [2023 (13) Centax 189 (SC)])***.
- The Impugned Order-in-Original pertains to an allegation that the Taxpayer failed to conclusively prove whether he has actually availed manpower services and that the Taxpayer did not produce documents such as register of workers, name of workers against whom invoices were raised, etc. to substantiate the actual receipt of service for furtherance of his business. The aforesaid allegations are beyond the scope of the allegations made in the SCN.
- Further, while observing that the Taxpayer had furnished Chartered Accountant certificates, the tax authorities proceeded to reject the certificates by merely observing that they do not reconcile with the facts stated in the returns as available on the GST portal. However, no clarification was sought by the tax authorities to clarify the aforesaid observation and the tax authorities merely proceeded to unilaterally reject the certificates without providing an opportunity of being heard.

Observations and Ruling by the High Court

- The Impugned Order-in-Original is unsustainable on account of the following reasons:
  - The findings of the Impugned Order-in-Original are outside the scope of the allegations in the SCN.
  - The Impugned Order-in-Original did not provide an opportunity of being heard to the Taxpayer to substantiate the claim of ITC based on the Chartered Accountant certificates furnished with the tax authorities.
- The law and the subject involved in the present case have been covered by the judgment in ***Suncraft Energy Pvt. Ltd. (supra)*** and hence, the same is squarely applicable to the present case.
- The action of the tax authorities without resorting to any action against the supplier and ignoring the invoices as well as the Chartered Accountant certificates furnished by the Taxpayer is erroneous and wholly without jurisdiction.
- If the tax authorities had admitted that the recipient i.e., the Taxpayer had made payment to the supplier against the transaction and if it is a case that such tax has not been remitted to the Government, the elementary principle would be to cause an enquiry with the supplier and without doing so, penalising the Taxpayer would be arbitrary, illegal and without jurisdiction.
- In view of the above, the intra-court appeal is allowed, and the order passed by the Calcutta High Court is set aside. Further, the SCN as well as the Impugned Order-in-Original is set aside with a direction to the tax authorities to proceed first against the supplier and only under exceptional circumstances as clarified in the press release[1], proceedings can be initiated against the Taxpayer.

[Lokenath Construction Pvt. Ltd. Vs. Tax/Revenue Government of West Bengal and Ors. [TS-261-HC(CAL)-2024-GST], dated 7 May 2024]

[1] Press Release dated 4 May 2018

Reimbursements Of Expenditures Made To Foreign Dealers Attract Service Tax Under Reverse Charge Mechanism

Facts of the case

- M/s Maruti Suzuki India Ltd. (Taxpayer) is a registered company engaged in the manufacturing of motor vehicles and their parts which are also exported to distributors/dealers in various countries, who subsequently sell such vehicles/parts. Such distributors are also responsible for providing after-sales services to the customers as well as fulfilling the warranty claims during the warranty period to foreign customers. The Taxpayer also reimburses expenditures incurred by its distributors such as export warranty, product recall charges and Goodwill warranty.
- In respect of such reimbursements, the Tax Authority issued three SCNs dated 8 June 2009, 30 September 2009 and 30 July 2010 for the period 18 April 2006 to 2008, 2008 to 2009 and 2009 to 2010 respectively, proposing to levy Service Tax under 'Business Auxiliary Services' (BAS) under Reverse Charge Mechanism (RCM).
- An Order-in-Original (OIO) dated 11 January 2011 was passed by the Tax Authority confirming the service tax demand along with interest and penalties by invoking the extended period of limitation and holding that the services rendered by the foreign distributors qualify as BAS under sub-section (i), (ii) and (iii) of Section 65(19) of the Finance Act, 1994.
- Aggrieved of the above, the Taxpayer filed an appeal before CESTAT Chandigarh.

Contentions of the Taxpayer

- It is a settled principle of law that the scope of an Order-in-Original cannot go beyond the scope of SCN. The impugned order is outside the scope of SCN as the clauses of BAS which are the basis of issuance of the impugned order were not mentioned in the SCN.
- Clause (i) of Section 65(19) covers the promotion, marketing or sale of goods produced or provided by the client as BAS. The relationship with the distributor is that of a manufacturer and dealer and there is no principal agent relationship with such dealers. The dealers act as independent contractors and are engaged as sales dealers of the Appellant as per Articles 5 and 12(b) of the Agreement and thus cannot be covered under clause (i) of the definition of BAS.
- Clause (ii) of Section 65(19) covers the promotion or marketing of service provided by the client. This clause also cannot be applied as the foreign dealers act only as sales dealers and provide warranty / after-sales services to the foreign customers thus acting as "an authorised service station" and not BAS.
- Further, Clause (iii) of Section 65(19) covers any service provided on behalf of the client. The dealers are not providing services to the customers on behalf of the Appellant and there is no client relation with the dealer, rather there is a relationship of manufacturer and dealer which has been held in ***Maruti Suzuki India Ltd. 2008 ((232) ELT 566 (Tri. Del.)) and Maruti Udyog Limited (2004 (170) E.E.T. 245 (Tri. Del.))***.
- The services provided by the dealers are more specifically covered under the definition of 'Authorised Service Stations'. Board Circular No. B11/1/2001-TRU dated 9 July 2001 provides that any service or repair provided by an authorised service station would be covered under the ambit of Service Tax. When the dealers are more specifically covered under the definition of authorised service stations, the Tax Authority cannot confirm demand under the general category (i.e. under BAS) which was also held in ***M/s. Uttam Toyota Vs CCE & ST, Ghaziabad, ST/1094/2010-CU (DB) CESTAT Allahabad order dated 27 December 2018 and M/s. Uttam Toyota Vs CCE, Ghaziabad 2019-TIOL-2930-CESTAT-ALL***.
- The service tax payable is admissible as credit as the said service amounts to input service and can be utilised in payment of excise duty on goods manufactured by it thus the entire process is revenue neutral. Further, the reimbursement of expenses does not form part of consideration under Section 67 of the Finance Act, 1944 read with Rule 5 of the Service Tax (Determination of Value) Rules, 2006 and thus the same cannot be subject to service tax.
- The Tax Authority cannot invoke the extended period of limitation for the SCN issued on 8 June 2009 pertaining to the period 18 April 2006 to 2008 as there was no wilful suppression of any fact. Also, interest under Section 75 and penalty under Sections 77 & 78 cannot be imposed when the service tax itself is not payable.

Contentions of the Tax Authority

- The contention of the Taxpayer that the SCN did not specify the sub-clause of BAS is not correct. It was held by the Hon'ble Supreme Court in ***Pradyumna Steel Ltd. Vs. CCE, Calcutta (1996 (82) ELT 441 (SC))*** that mere mentioning of a wrong provision of law is not sufficient to invalidate the proceedings when the power exercised is available under a different provision of law.
- The dealers are providing service, repairs, etc. of motor vehicles to foreign customers and not to the Taxpayer. The services provided by the foreign dealers to the Taxpayer do not qualify as Authorised Service Stations as the foreign dealers are providing services to their customers.
- The foreign dealers are providing services to the customers on behalf of the Taxpayer which falls within the definition of BAS and the Taxpayer is liable to pay service tax on a reverse charge mechanism for the services provided by the foreign dealers to the Taxpayer.
- It is held in the case of ***Hyundai Motors (India) Pvt. Ltd. (supra)*** that the foreign dealers are providing Business Auxiliary Services. Also, the facts of the cases relied on by the Taxpayer are different from those of the present case.
- Further, the Taxpayer being a recipient of BAS is required to pay service tax on the gross expenditure incurred on such services. The period of limitation was not invoked as the Taxpayer intentionally suppressed the figures of expenses in the ST-3 returns with an intent to evade service tax, specifically when service

tax was being paid by the Taxpayer on advertising expenses which is also part of the same agreement.

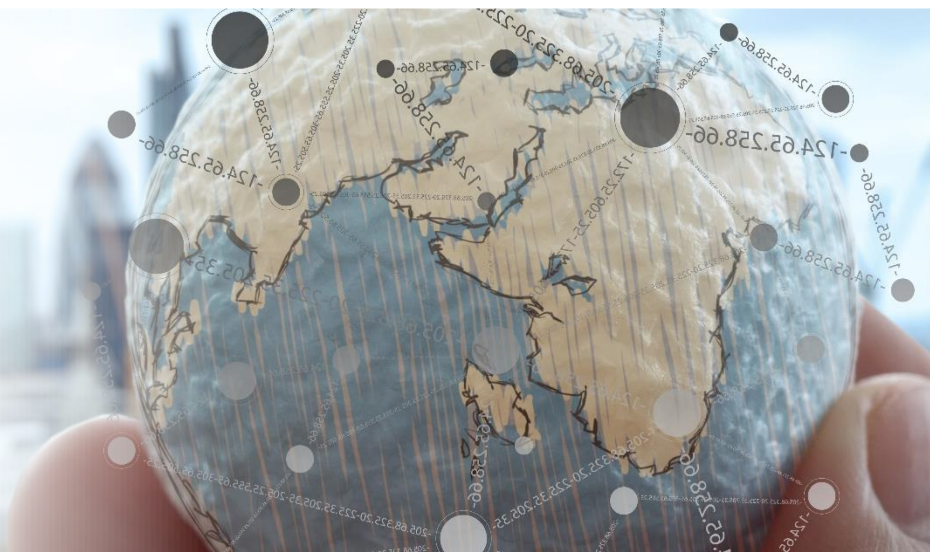
- Also, three orders were passed after issuing three SCNs to the Taxpayer. Thus, the Taxpayer was required to file separate appeals against each of the orders.

Observations and Ruling by the CESTAT

- The contention of the Taxpayer that the SCN did not specify the sub-clause of BAS which was mentioned in the impugned orders would not vitiate the proceedings. The SCN was issued alleging that the taxpayers have not paid service tax under BAS on various services received by them from their foreign dealers. Even though the specific sub-clauses were not mentioned in the SCN, the intent of the Tax Authority was clear. It was also held by the Hon'ble Supreme Court in ***Pradyumna Steel Ltd. (supra)*** that mere mentioning of a wrong provision of law would not invalidate the proceedings when the power exercised is available in a different provision of law.
- The foreign customers perceive that the free repair services during the warranty period are provided by the manufacturer i.e. the Taxpayer, even though the same are being provided by the foreign dealers. Thus, it can be said that the dealer is performing such activities on behalf of the Taxpayer.
- Also, it was held by the Chennai Bench of the Tribunal in ***Hyundai Motors India Pvt. Ltd. (supra)*** that the foreign dealers are providing services classifiable under BAS to the Taxpayer. Thus, in the present case too, the services rendered by the foreign dealers would be classified as BAS and are required to pay service tax on a reverse charge basis.
- The contention of the Taxpayer that the issue is revenue neutral since the amount payable as service tax would be available to them as CENVAT Credit is not good in law as it would disturb the very scheme of CENVAT credit.
- Also, the exemption under Notification No.12/2003-ST dated 20 June 2003 is available only when goods are sold during the course of the provision of service, CENVAT credit is not availed and there is documentary evidence in relation to the said goods. Since there is no documentary evidence provided by the Taxpayer, the exemption would not be available and the value of taxable service for the computation of service tax shall be the gross amount paid by the recipient of such service.
- The limitation of an extended period cannot be invoked in the case of SCN issued on 8 June 2009 for the period pertaining to 18 April 2006 to 2008 as the Taxpayer was regularly filing ST-3 returns and was also subjected to regular audit which shows that there was no wilful suppression of facts by the Taxpayer. In such cases, the imposition of penalty on the Taxpayer is also not justified.
- Further, the contention of the Tax Authority that the appeal is not valid as only one appeal was filed for three orders is not good as assigning three numbers to one impugned order does not make it three different orders. After considering Rule 6A of the CESTAT (Procedure) Rules, 1982 and the order passed in ***Satake India Engineering Pvt. Ltd. (2014 (303) ELT 451),*** it can be concluded that the Taxpayer has correctly filed a single appeal against one impugned order.
- In view of the above, the demand for the normal period is allowed and the imposed penalties are set aside. Thus, the appeal is partially allowed.

[M/s. Maruti Suzuki India Ltd. Vs. The Commissioner of Service Tax, Delhi [TS-165-CESTAT-2024-ST], dated 3 May 2024]

TRANSFER PRICING



Hon'ble Tax Tribunal, Mumbai: Adjudicates ALP Determination For Provision Of Financial Guarantee And Performance Guarantee As Well As Issuance Of Letter Of Comfort; Holds That Issuance Of Letter Of Comfort Does Not Constitute An International Transaction

The taxpayer is engaged in civil construction, real estate, trading of construction materials, and construction-related services. In AY 2014-15, the taxpayer issued a performance guarantee, financial guarantee, and letter of comfort to banks on behalf of its Associated Enterprises (AEs).

During the course of Transfer Pricing (TP) proceedings, the Transfer Pricing Officer (TPO) determined the Arm's Length Price (ALP) of commission for the issuance of a letter of comfort at 0.75%, and for the provision of performance guarantee as well as a financial guarantee at 1.50%.

The taxpayer had challenged the aforesaid TP adjustments before the Commissioner of Income Tax (Appeals) [CITA(A)]. The CIT(A) partially upheld the adjustments, thereby restricting the ALP from issuing letter of comfort to 0.20% and the provision of a financial guarantee to 0.50%. CIT(A) deleted the addition for provision of performance guarantee as it had expired during the AY under consideration.

The taxpayer as well as the Department preferred to appeal against the CIT(A)'s order before the Hon'ble Tax Tribunal, wherein the bone of contention was whether or not an issuance of letter of comfort constituted an international transaction:

- The taxpayer asserted that a letter of comfort did not constitute an international transaction as Explanation 'c' to Section 92B of the Income-tax Act, 1961 (the Act) does not include letter of comfort under the definition of International Transaction and even the Safe Harbour Rules explicitly define "corporate guarantee" and exclude letter of comfort from the definition therein.
- The Department's stance was that letter of comfort creates a financial liability on the taxpayer to make good any default on the part of the AE, to the extent of the taxpayer's equity holding in its AE.

The Hon'ble Tax Tribunal held that:

- Several decisions of the Jurisdictional High Court have established that a letter of comfort provided by the taxpayer on behalf of its AE does not constitute an international transaction, hence obviating the need for determining its ALP.
- Since the performance guarantee had expired, its ALP was not to be determined, affirming the deletion of TP adjustment by the CIT(A).
- Provision of financial guarantee is an international transaction, yet neither the taxpayer nor the tax authorities had followed the methodology for determining the ALP as prescribed in the Act. The Hon'ble Tax Tribunal remanded the matter back to the TPO for determination of ALP as per one of the prescribed methods, also stating that ALP determination of an international transaction needs to be carried out for every taxpayer for each AY, and ALP determined in another case or for another AY in the taxpayer's case cannot be a detrimental factor thereto.

Citation: Shapoorji Pallonji and Company Private Limited [TS-147-ITAT-2024(Mum)-TP]

Hon’ble Tax Tribunal, Delhi: Remits Matter In Relation To TP Adjustment Towards Notional Interest On Delayed Export Receivables Back To CIT(A) For Fresh Examination

The taxpayer is engaged in the business of wire and cable manufacturing. The taxpayer was in appeal before the Hon’ble Income-tax Appellate Tribunal (Tax Tribunal) against an order from the CIT(A) regarding the addition of notional interest on delayed receipt of export proceeds from AEs of the taxpayer.

The taxpayer contended that:

- Delayed receipt of export proceeds from AEs is not an international transaction under section 92B of the Act.
- The TPO had already accepted that the underlying export transactions were at arm’s length, hence no separate benchmarking for delay in receipt of accounts receivable was warranted.
- The delay in receiving export proceeds was minimal and for very few days.
- No interest is charged to non-AEs for pending receivables and the treatment given to export receivables from non-AEs should be applied to AEs as well.

These contentions were dismissed by the CIT(A) without examination, stating that they were not raised before the Assessing Officer (AO) during the course of assessment proceedings, citing the Supreme Court judgment in the case of Goetze India Ltd. vs. CIT, 284 ITR 323 (SC).

The Hon’ble Tax Tribunal observed that the Supreme Court judgment cited by the CIT(A) was not applicable in this case as the said judgment did not put any restrictions on the taxpayer to raise a new plea on the subject matter of the dispute before the appellate authorities. The taxpayer had merely raised a new facet of the argument and CIT(A) was not justified in dismissing the same. Accordingly, the Hon’ble Tax Tribunal remanded the matter back to the CIT(A) for fresh examination. The taxpayer was instructed to raise all contentions and provide the necessary evidence to challenge the TP adjustment.

Citation: Paramount Communication Pvt Ltd [TS-148-ITAT-2024(DEL)-TP]

Hon’ble Tax Tribunal, Mumbai: Distinguishes Letter Of Comfort Vis-à-vis Letter Of Guarantee; Deletes TP Adjustment

The taxpayer is engaged in the business of manufacture and sale of pharmaceutical products, and during AY 2013-14 had issued a letter of comfort on behalf of its AE to a third-party bank for supporting credit facilities extended by the bank to said AE.

The TPO treated this as an international transaction and benchmarked it, relying on judicial precedents in the case of Everest Kanto Cylinder Limited and Glenmark Pharmaceuticals Limited. The TPO made an adjustment of 1.50% towards the guarantee commission based on the aforesaid judgements.

Upon appeal, the CIT(A) upheld the TP adjustment, holding that the letter of comfort was essentially a guarantee, implying a financial obligation on the part of the taxpayer to the bank.

In an appeal before the Hon’ble Tax Tribunal, the taxpayer contended that the guarantee commission is only justified when the letter of comfort creates a legally binding obligation for the taxpayer to cover losses in case of default by the borrower, whereas the letter of comfort merely expressed intent and did not establish any such obligation.

The Hon’ble Tax Tribunal examined the terms of the letter of comfort and the letter of offer from the bank. It held that the letter of comfort did not impose a financial obligation on the taxpayer but on the borrower, as evidenced by the terms of the letter of offer. The Hon’ble Tax Tribunal noted that while a corporate guarantee entails a binding commitment to indemnify the lender, a letter of comfort does not involve such a commitment.

Considering the specifics of the case and the fact that the definition of "corporate guarantee" as mentioned in Rule 10TA of Income-tax Rules, 1962 (Safe Harbour Rules for International Transactions) explicitly includes corporate guarantee and specifically excludes letter of comfort, the Hon’ble Tax Tribunal ruled that the letter of comfort could not be equated with a guarantee warranting a TP adjustment. Consequently, it annulled the adjustment made by the TPO.

Citation: Lupin Limited [TS-118-ITAT-2024(Mum)-TP]

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