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ACCOUNTING UPDATES

ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

EAC OPINION

ACCOUNTING TREATMENT OF OTHER INCOME (BANK INTEREST ON FUNDS INVESTED OUT OF ADVANCE RECEIVED FROM MINISTRY OF RAILWAYS (MOR) TERMED AS EXTERNAL AIDED PROJECT (EAP)) UNDER IND AS FRAMEWORK

Facts of the Case

The Mumbai-Ahmedabad High-Speed Rail (MAHSR) Project (hereinafter referred to as 'the Project') was approved by Cabinet on 09.12.2015 and thereafter a public limited company (hereinafter referred to as 'the Company') was incorporated in India under the provisions of Companies Act, 2013 on 12 February 2016, with the object to plan, design, develop, build, commission, maintain, operate and finance high-speed rail services between the State of Maharashtra and State of Gujarat and/or any other area either on its own or by taking over or leasing or otherwise of any other model and build new transit route of any mode or a combination of mode with all attendant infrastructure facilities, as may be approved by the Ministry of Railways (MoR) or the Government of India (GoI) or any other such competent authority. The capital cost of the Project is approx. INR 1.08 lakh crore. For the total cost of the Project, funds have been arranged by the Company in the form of equity from MoR, State Governments and the form of a soft loan from the Japan International Cooperation Agency(JICA).

The Company is incorporated and engaged in one and only activity, i.e. the Project between two states. The Project includes activities from the acquisition of land, earthwork, laying tracks, station building, signalling and telecommunication, overhead electricity, bridges, tunnels, stations, training institute etc.

The Company has stated that statutory audit is carried out by statutory auditors appointed by the Comptroller and Auditor General of India (CAG) under section 139 of the Companies Act, 2013 and supplementary audit is carried out by the CAG under section 143(6) (a) of the Companies Act, 2013. During the course of the supplementary audit by the CAG, certain observations were made, details of which are as follows:

Other Income

- The Company has earned interest income of INR 121.14 crore, details of the same are given below. During the financial year (F.Y.) 2021-22, the Company has 'Other Income (Bank Interest on Funds invested out of advance received from the Ministry of Railways (MoR) termed as External Aided Project (EAP) and out of share capital)'.

(INR in crore)

(A) INCOME HEAD	AMOUNT FOR THE F.Y. 2021-22
OTHER INCOME	
Interest on EAP as per CAG observation	98.68
Other Interest Income	22.46
TOTAL	121.14

- Ministry of Finance (MoF) has executed the following agreements (as of 31 March 2022) with Japan International Cooperation Agency (JICA) for availing loan facilities for the Project. The repayment period is 50 years (including a grace period of 15 years). The rate of interest is 0.1 per cent per annum.

PURPOSE	CONSTRUCTION OF TRAINING INSTITUTE FOR THE PROJECT	CONSTRUCTION OF THEPROJECT	CONSTRUCTION OF THE PROJECT
Sanctioned Loan Amount (in Million JPY)	10,453	89,547	1,50,000
Date of Signing of Loan Agreement	15-09-2017	28-09-2018	29-10-2018

- Consequently, the Ministry of Railways (MoR) has released a partial sum of INR. 13,200/- crore (Previous Year INR 2,000/- crore) to the Company as EAP against JICA Loan till 31 March 2022.
- The terms and conditions in relation to the above EAP between the Company and MoR are under consideration as of the date of these financial statements. Pending finalisation of the related terms and conditions, the Company has presented the above EAP under the head 'Financial liabilities - non-current' and no consequential expenses have been recorded in these financial statements.
- The Company will own the assets created on the Project.
- The Company has received funds as EAP from the GoI against the loans by GoI from JICA to finance the Project.
- As per the current arrangement, expenditure is first made by the Company, and a claim is then raised by the Company to JICA. JICA after its due diligence, reimburses the money to MoF.
- MoF through its Gross Budgetary Support (GBS) arrangement with MoR, along with other expenditures of MoR also releases the funds for the Project to the Company throughout the year, based on the availability with MoR.
- i. The procedure for disbursement can be summarised as follows:
  - MoR transfers funds to the Company out of its budgetary sources.
  - Thereafter, the Company incurs the expenditure and makes payments to the contractor.
  - The Company submits a reimbursement claim to JICA.
  - JICA remits funds to MoF and funds disbursed by MoR at step (i) above are recouped.
  - Interest on loan as per terms of agreement starts for MoF as and when funds are disbursed by JICA to MoF.
  - As at present, terms and conditions are not finalised between the Company and MoF/MoR, *MoF and MoR does not charge any financing cost/ borrowing costs on funds released to the Company.*
- The amount of EAP funds is accounted for in the books of account of the Company as 'Advance' upon receipt, pending finalisation of terms and conditions. The fact has also been disclosed in financial statements by way of Note 13.2 of financial statements.
- The Company places deposits in banks out of these funds received in the form of equity capital and EAP pending utilisation for the MAHSR project.

Observations made by CAG: The CAG has made the following observations/comments on the accounting treatment of the above items:

- Comment on Profitability Statement of Profit and Loss
  - Other Income (Note 20) –INR 123.18 crores
  - Capital Work in Progress (Note 4) – INR 10,197.28 crores

The above includes INR 121.14 crores being the interest earned by the Company on deposits of surplus funds (Equity and Externally Aided Projects fund). Ministry of Railways releases funds to the Company in advance towards equity and Externally Aided Projects (EAP). The funds are temporarily invested by the Company in Bank Deposits.

As per the accounting policy 2.6 regarding capital work in progress of the Company, the income pertaining to the construction period and other incidental income such as interest income (other than from temporary deployment of funds received by way of equity) is adjusted against the expenditure during construction.

However, the Company is in violation of its above accounting policy and has shown interest earned on EAP fund as its income instead of adjusting the same with the expenditure during construction (Capital Work in Progress). This has resulted in the overstatement of 'Other income', 'Profit before tax' and 'Capital work in progress' by INR 98.68 crore.

Management Reply to observations of CAG

Guidance for Property, Plant and Equipment is provided in Indian Accounting Standard (Ind AS) 16, 'Property, Plant and Equipment'; relevant extracts from Ind AS 16 are as follows:

Paragraph 21 of Ind AS 16 provides that some operations occur in connection with the construction or development of an item of property, plant, and equipment, but are not necessary to bring the item to the location and condition

necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, income may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss and included in their respective classifications of income and expense.

It is clear from the above paragraph that income and related expenses of incidental operations that are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management are recognised in profit or loss and included in their respective classifications of income and expense.

The Company has received funds as EAP from GoI against the loans by GoI from JICA to finance the Project. As per the current arrangement, expenditure is first made by the Company, a claim is then raised by the Company to JICA. JICA after its due diligence, reimburses the money to MoF. MoF through its GBS arrangement with MoR, along with other expenditures of MoR also gives the amounts for the Project. MoR releases the funds to the Company throughout the year based on the availability of MoR. Hence, for a project of this nature and magnitude where funds are sought by agencies including State Governments at short notice and thus funds balances are required to be maintained, EAP funds are placed by the GoI at the disposal of the Company to meet project expenditure on items eligible to be financed under loan agreements since the loans are available on a reimbursement basis only to the GoI. *However, MoF and MoR do not charge any financing cost on funds released to the Company*

The funds are accounted for in the books of account of the Company as an advance upon receipt pending finalisation of terms and conditions. The fact has also been disclosed in financial statements. The funds upon receipt are normally kept in banking instruments like fixed deposit receipts (FDRs). The funds are kept temporarily with the banks as FDRs are for business purposes for safety and Corporate Governance.

The Company has further submitted that interest income earned does not have any kind of nexus with Capital Work in Progress, interest income in any way does not make any impact on construction activities or cost of construction. It will not make any difference if the Company invests funds in FDRs or keeps these idle to the cost of construction of the Company or activities related to construction. In view of the above, it is clear that there is no nexus between the construction of the Project and interest income from FDRs.

Further, requirements of Ind AS 23, 'Borrowing Costs' also cannot be applied since there are no borrowing costs to be capitalised as well as there is no interest income earned by the Company when it becomes borrowings for the Government of India (i.e. date of start of interest charge by JICA to the MoR). Accordingly, it can be summarised that the Company has correctly recognised interest earned in the Statement of Profit and Loss on the amount of EAP pending disbursement by JICA to the GoI. Furthermore, the accounting policy of the Company as stated in the financial statements is as follows:

"the income pertaining to the construction period and other incidental income such as interest income (other than from temporary deployment of funds received by way of equity) is adjusted against the expenditure during construction."

The policy of the Company provides an example of incidental income with the word 'such as' and is in the nature of the 'ejusdem generis' and it is not an exhaustive list. It is also submitted that the accounting policy of the Company cannot violate the requirements of Ind AS and therefore application of Ind AS is required to be taken care of. The Company is following the requirements of Ind AS. The provisional comment does not say that the Company is not following Ind AS but referred the violation of its accounting policy. It is submitted that the Company shall review the accounting policy in this regard and the language of the policy shall be redrafted/reworded in compliance with the Accounting Standard.

The assurance given by the Company to CAG

It is also assured that since there is a difference of interpretation by the Company and Provisional Comments of C&AG on the matters, the matter shall be referred to the Expert Advisory Committee

(EAC) of the Institute of Chartered Accountants of India (ICAI) for its opinion.

Additional points for consideration by EAC

In this whole issue along with the reply submitted to CAG, the Company also submits the following for the consideration of EAC:

- Since interest income is not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, this cannot be deducted from the cost of assets in accordance with Ind AS 16.
- Ind AS 23, 'Borrowing Costs' cannot be applied since the amount is converted to a loan for MoF only after releasing of funds by JICA to MoF; Ind AS 23 provides in paragraphs 5, 12 and 13 as follows:
  - 5."Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds."
  - 12."To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings."
  - 13."The financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset. In such circumstances, the funds are often temporarily

invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred."

It is clear from paragraphs 5, 12 and 13 of Ind AS 23 reproduced above that the borrowing cost to be capitalised is to be adjusted with the income earned from temporary investment of borrowed funds while the project is in the stage of construction. Thus, the income earned during the construction period can be set off only against the borrowing costs to be capitalised as per the principles of Ind AS 23, and the interest income out of investment on temporary parking of funds with banks as FDs cannot be adjusted and the same shall have to be recognised in the Statement of Profit and Loss.

- Since there are no borrowing costs to be capitalised related to EAP funds, interest income on temporary deployment of funds cannot be reduced from the cost of Property, Plant and Equipment (PPE).
- Ind AS 23 speaks only for the cost of borrowings to be capitalised and Ind AS 16, 'Property, Plant and Equipment' does not speak for borrowing costs or interest income. Therefore, if there are no borrowing costs, then interest income cannot be credited to Capital Work in Progress.
- Ind AS 32, 'Financial Instruments: Presentation' provides guidance for the treatment of interest in financial statements; the relevant extract of paragraph 35 of Ind AS 32 is reproduced below:

  "35 Interest, dividends, losses and gains relating to a financial instrument or a component that is a financial liability shall be recognised as income or expense in profit or loss. …"

  It is clear from above that interest income on financial instruments (fixed deposits in the case of the Company) shall be recognised as income in the Statement of Profit or Loss.
- Since the amount of interest receipt cannot be reduced from project assets in accordance with Ind AS 16 and Ind AS 23, interest should be recognised in profit or loss in compliance with Ind AS 32.

Query

In view of the above, the Company has sought the opinion of the Expert Advisory Committee of the Institute of Chartered Accountants of India on the following issues:

- Whether accounting treatment of other income being interest income of INR 121.14 crores for the year ended 31 March 2022 by the Company, is correct. If not, what should be the treatment in the opinion of the Committee as per applicable Ind AS?
- If there is any different accounting treatment as compared to the treatment done by the Company in financial statements, are these changes to be treated as changes in estimate, accounting policy or prior period errors?

Points considered by the Committee

The Committee noted that the basic issue raised by the Company relates to the accounting treatment of interest income on funds invested out of funds received from MoF/MoR/GoI as External Aided Project (EAP) funds against a loan from JICA and classified under the head 'Financial liabilities – non-current'. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case. Further, the Indian Accounting Standards referred to in the opinion are the Standards notified under the Companies (Indian Accounting Standards) Rules, 2015, as revised or amended from time to time. Furthermore, the Committee notes that in the financial statements of the Company for the financial year 2021-22, the amount received as EAP has been disclosed under 'Financial Liabilities - non-current'; however, the Committee has not examined the appropriateness of such disclosure as per Schedule III to the Companies Act, 2013.

At the outset, the Committee notes from the Facts of the Case that the Company receives funds as EAP funds from MoF/MoR/GoI against loans to the GoI from JICA to finance the Project. EAP funds are placed by the GoI at the disposal of the Company to meet the project expenditure on items eligible to be financed under loan agreements since the loans are available on a reimbursement basis only to the GoI. However, it is stated in the Facts that as of present, terms and conditions are not finalised between the Company and MoF/MoR, MoF and MoR do not charge any financing cost/borrowing costs on funds released to the Company. Furthermore, it is noted that in the financial statements of the Company, the EAP funds have been presented as 'Other financial liabilities (at amortised cost)' under the head 'Financial Liabilities – Non-current'. From this, the Committee understands that at present, the GoI/MoF/MoR are lending funds to the Company and only the terms and conditions with regard to the interest and repayment are yet to be finalised. However, the Committee also notes that the Company is measuring the said financial liabilities at amortised cost which requires the use of an effective interest method as per the relevant definitions given hereafter. In this context, the Committee notes the requirements of Ind AS 23, 'Borrowing Costs' as follows:

"Borrowing costs are interest and other costs that an entity incurs in connection with the borrowing of funds."

"6 Borrowing costs may include:

- interest expense calculated using the effective interest method as described in Ind AS 109, Financial Instruments; …"

From the above, the Committee notes that Ind AS 23 specifies that borrowing costs include interest

expense calculated using the effective interest method as described in Ind AS 109, 'Financial Instruments'. In this regard, the Committee notes the following requirements of Indian Accounting Standard (Ind AS) 109, 'Financial Instruments':

"5.1.1 Except for trade receivables within the scope of paragraph 5.1.3, at initial recognition, an entity shall measure a financial asset or financial liability at its fair value plus or minus, in the case of a financial asset or financial liability not at fair value through profit or loss, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability."

"B5.1.1 The fair value of a financial instrument's initial recognition is normally the transaction price (i.e. the fair value of the consideration given or received, see also paragraph B5.1.2A and Ind AS 113).

However, if part of the consideration given or received is for something other than the financial instrument, an entity shall measure the fair value of the financial instrument. For example, the fair value of a long-term loan or receivable that carries no interest can be measured as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of income unless it qualifies for recognition as some other type of asset."

"Effective Interest Method - The method that is used in the calculation of the amortised cost of a financial asset or a financial liability and the allocation and recognition of the interest revenue or interest expense in profit or loss over the relevant period.

Effective Interest Rate - The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or the amortised cost of a financial liability. When calculating the effective interest rate, an entity shall estimate the expected cash flows by considering all the contractual terms of the financial instrument (for example, prepayment, extension, call and similar options) but shall not consider the expected credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see paragraphs B5.4.1– B5.4.3), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to reliably estimate the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments)."

From the above, the Committee is of the view that the Company, in the extant case, should recognise initially financial liability for the EAP funds by applying principles of Ind AS 109 and calculate interest/ borrowing cost on such financial liability for the EAP funds using effective interest method as per the above-reproduced requirements of Ind AS 109.

With regard to the issue raised in connection with the accounting treatment of interest income on funds invested out of surplus EAP funds classified as a financial liability, the Committee notes paragraphs 8, 12 and 13 of Ind AS 23, 'Borrowing Costs' as follows:

"Recognition

- 8. An entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. An entity shall recognise other borrowing costs as an expense in the period in which it incurs them."
- 12. To the extent that an entity borrows funds specifically for the purpose of obtaining a qualifying asset, the entity shall determine the amount of borrowing costs eligible for capitalisation as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.
- 13. The financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for expenditures on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their expenditure on the qualifying asset. In determining the amount of borrowing costs eligible for capitalisation during a period, any investment income earned on such funds is deducted from the borrowing costs incurred."

The Committee notes from the above requirements of Ind AS 23 that an entity shall capitalise borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset as part of the cost of that asset. It further states that the borrowing cost (on specific borrowed funds) to be capitalised is to be adjusted with the income earned from the temporary investment of such borrowed funds while the project is in the stage of construction. Thus, the income earned on the amount invested out of the borrowed funds during the construction period is to be set off against the borrowing costs to be capitalised as per the principles of Ind AS 23. Accordingly, in the extant case, the interest income to the extent of the borrowing costs should be adjusted against the said borrowing costs (which are presumed to be incurred on funds borrowed specifically for the Project) calculated using the effective interest method as discussed above and which is to be capitalised in the cost of the asset as per the requirements of Ind AS 23.

Further, with regard to the treatment of any excess/surplus interest income earned on bank deposits (which is a financial instrument as per the requirements of Ind AS 32, 'Financial Instruments: Presentation') over and above the borrowing costs incurred during the construction period, the Committee notes the requirements of Ind AS 23 as reproduced above, and the following requirements of Ind AS 107, 'Financial Instruments: Disclosures' and Ind AS 1, 'Presentation of Financial Statements':

Ind AS 107

"20 entity shall disclose the following items of income, expense, gains, or losses either in the statement of profit and loss or in the notes:

- …
- Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets that are measured at amortised cost …

Ind AS 1

"82 In addition to items required by other Ind ASs, the profit or loss section of the statement of profit and loss shall include line items that present the following amounts for the period:

- revenue, presenting separately interest revenue calculated using the effective interest method

…"

"88 An entity shall recognise all items of income and expense in a period in profit or loss unless an Ind AS requires or permits otherwise."

The Committee notes from the above requirements of Ind AS 107 and Ind AS 1 that interest revenue is to be recognised in the Statement of Profit and Loss unless an Ind AS requires or permits otherwise.

In this regard, the Committee notes that Ind AS 23 requires interest on specific borrowed funds that are directly attributable to the acquisition, construction or production of a qualifying asset to be capitalised as part of the cost of that asset is to be adjusted with any investment income on the temporary investment of those borrowings.

In other words, Ind AS 23 requires adjustment of interest income against borrowing cost to be capitalised. Thus, the Committee is of the view that excess/surplus income over and above the interest expense/borrowing cost is not specifically dealt with in Ind AS 23. Also, the Committee notes that such excess interest income does not arise from activities necessary for bringing an item of PPE to the location and condition necessary for it to be capable of operating in the manner intended by management and, therefore, it is not eligible for capitalisation under Ind AS 16, 'Property, Plant and Equipment'. Thus, such excess interest income should be recognised in the Statement of Profit and Loss as per the requirements of Ind AS 1 read with Ind AS 107.

The Committee is of the view that in the extant case, since the Company did not follow the above-mentioned accounting treatment, the same should be rectified in the current reporting period, considering it as an error, as per the following requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

"Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- Was available when financial statements for those periods were approved for issue; and
- Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud."

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

42. Subject to paragraph 43, an entity shall correct material prior period errors retrospectively in the first set of financial statements approved for issue after their discovery by:

- restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented."

Opinion

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

- The interest income to the extent of the borrowing costs, calculated using the effective interest method, as discussed above should be adjusted against the said borrowing costs to be capitalised in the cost of the asset as per the requirements of Ind AS 23. The excess/surplus interest income (if any) should be recognised in the Statement of Profit and Loss, as per the requirements of Ind AS 1 read with Ind AS 107. Thus, the accounting treatment followed by the Company in respect of interest income on EAP funds is not appropriate.
- Since the Company did not follow the abovementioned accounting treatment, the same should be rectified in the current reporting period, considering it as an error, as per the requirements of Ind AS 8, 'Accounting Policies, Changes in Accounting Estimates and Errors'.

REGULATORY UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

EXPOSURE DRAFT OF THE GUIDANCE NOTE ON AUDIT OF BANKS (2024 EDITION)

Auditing and Assurance Standards Board of ICAI vide announcement dated 10 December 2023, issued a revised edition of the "Guidance Note on Audit of Banks" by releasing an Exposure Draft for public comments. The comments on the Exposure Draft could be submitted by 31 December 2023.

This guidance note provides detailed guidance to auditors on statutory audits of banks and bank branches. The exposure draft is divided into two sections:

Section A: Statutory Central Audit

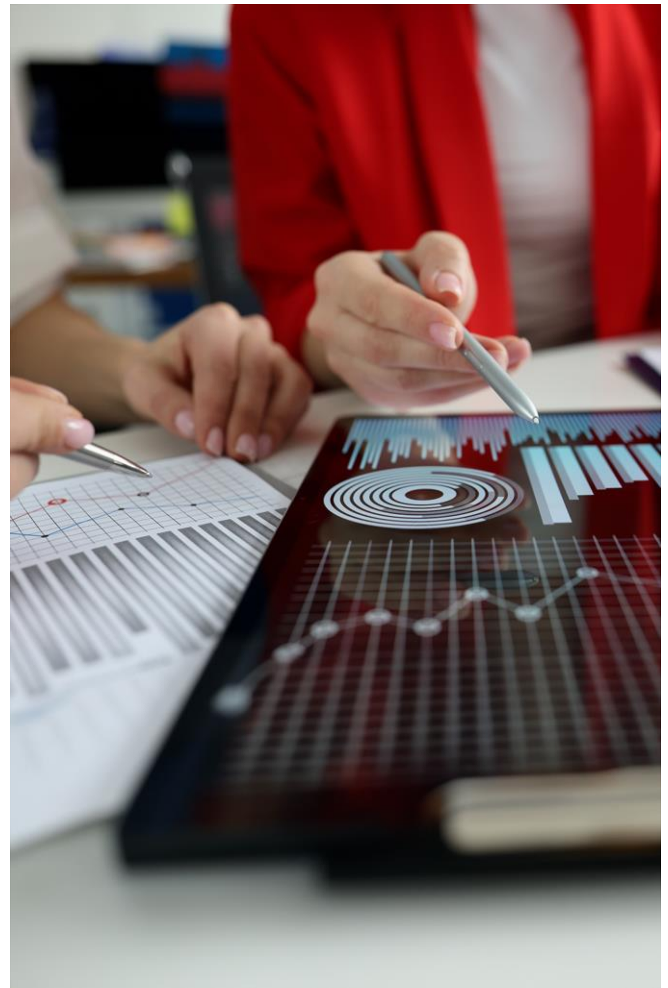
Section B: Bank Branch Audit

EXPOSURE DRAFT ON FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY - PROPOSED AMENDMENTS TO IAS 32, IFRS 7 AND IAS 1

The Accounting Standards Board (ASB) of ICAI vide announcement dated 12 December 2023, invites comments on the consultative documents issued by the International Accounting Standards Board (IASB) of IFRS Foundation with the aim to provide an opportunity to the various stakeholders in India to raise their concerns at the initial International Standard-setting stage itself, on the new/amendments to IFRS Standards.

In view of challenges in classifying complex financial instruments that combine some characteristics of both debt—financial liabilities—and ordinary shares—equity instruments, the proposals in the Exposure Draft include:

- Clarification of the underlying classification principles of IAS 32 to help companies distinguish between financial liabilities and equity
- Disclosures to further explain complexities around instruments that have both financial liability and equity characteristics; and



- Presentation requirements for amounts—including profit and total comprehensive income—attributable to ordinary shareholders separately from amounts attributable to other holders of equity instruments.

The Exposure Draft is open for public comments till 10 February 2024.

EXPOSURE DRAFT ON PROPOSED CONSEQUENTIAL PROVISIONS FOR NON-COMPLIANCE WITH CPE HOURS REQUIREMENT ON A YEARLY BASIS FROM CALENDAR YEAR 2024 ONWARDS

The Continuing Professional Education (CPE) committee of ICAI vide announcement dated 18 December 2023, has released an Exposure Draft outlining consequential provisions for non-compliance with CPE hours.

As per the Exposure draft, if the non-compliance with the requirement of CPE hours continues even after the stated multiple opportunities, the CPE Committee may refer the matter to the Disciplinary Directorate for action as deemed fit for the violation of these guidelines. The Council may relax any of the requirements of these guidelines either generally or by issuing specific instructions on a case-to-case basis for reasons to be recorded in writing.

The draft seeks feedback from members till 2 January 2024 and to be operational from to be operational with effect from 1 January 2025 for non-compliances arising from the calendar year 2024.

EMPANELMENT OF CHARTERED ACCOUNTANT FIRMS/LLPS FOR THE YEAR 2024-2025

ICAI has issued an announcement dated 28 December 2023 inviting applications from Chartered Accountant firms/ LLPs who desire to be empanelled with the office of the Comptroller and Auditor General of India (CAG) for the year 2024-2025 for consideration for appointment as auditors of Companies as per Sections 139(5) and 139(7) of the Companies Act, 2013 and of Statutory Corporations/Autonomous Bodies.

Online applications are available from 5 January to 15 February 2024. Firms/LLPs must fill/ update their data showing the status of their firm as of 1 January 2024 and generate an online acknowledgement letter, submitting it along with supporting documents to the CAG office by 28 February 2024.

CLARIFICATION REGARDING GUIDELINES ISSUED BY RBI FOR APPOINTMENT OF (STATUTORY CENTRAL AUDITORS) SCAS/ STATUTORY AUDITORS (SA'S) OF COMMERCIAL BANKS (EXCLUDING RRBS), UCBS AND NBFCS (INCLUDING HFCS)

ICAI vide announcement dated 28 December 2023, confirmed clarification issued by Reserve Bank of India (RBI) that concurrent audit assignments fall under the framework of point 6.4 in the Circular dated 27 April 2021, issued by RBI in respect of "Guidelines for the Appointment of SCAs and SAs of Commercial Banks (Excluding RRBs), UCBs, and NBFCs (including HFCs)".

Point 6.4 states that the time gap between any non-audit works (services mentioned in Section 144 of Companies Act, 2013, Internal assignments, special assignments, etc.) by the SCAs/SAs for the Entities or any audit/non-audit works for its group entities should be at least one year, before or after its appointment as SCAs/SAs.

ICAI has urged members to comply with this clarification for independent assessment of auditors.

RESERVE BANK OF INDIA (RBI)

INVESTMENTS IN ALTERNATIVE INVESTMENT FUNDS (AIFS)

RBI has issued a notification dated 19 December 2023, emphasising to prevent banks and non-banking financial companies (NBFCs) from utilising the alternative investment fund (AIF) route to 'evergreen' their loans. Regulated entities (REs) are advised not to invest in AIF schemes with downstream investments in debtor companies of the RE. Additionally, if an AIF scheme, in which an RE is already an investor, goes on to make downstream investments in any of the debtor companies associated with the RE (companies that have borrowed from or received investments from the RE), the RE is required to sell off its investments in that AIF scheme within a timeline of 30 days from the date of such downstream investment by the AIF.

Failure to comply within this timeframe will result in the RE being obligated to make a full 100 per cent provision on those investments. Further, investment in subordinated units of AIF schemes with a 'priority distribution model' will lead to a full deduction from RE's capital funds.

These instructions aim to tackle concerns regarding the substitution of direct loan exposure of RE's to borrowers, with indirect exposures through investments in AIFs and shall become effective immediately.

FOREIGN EXCHANGE MANAGEMENT (MANNER OF RECEIPT AND PAYMENT) REGULATIONS, 2023

RBI has issued a notification dated 21 December 2023, emphasising the manner in which residents in India can make or receive payments from individuals outside the country in supersession of notification dated 2 May 2016.

The regulation provides that, no person resident in India shall make or receive payment from a person resident outside India, provided that the RBI may, on an application made to it, permit a person resident in India to make or receive payment under the Act. Further, all the receipts and payments between a person resident in India and a person resident outside India shall be made through an Authorised Bank or Authorised Person.

It has bifurcated the transactions for receipt and payment into two categories:

- **Trade Transactions** - The receipt/payment for export to or import of eligible goods and services
  - **From Nepal and Bhutan**

  Such receipts/payments shall be in Indian Rupees. However, in the case of exports from India, where the importer in Nepal has been permitted by the Nepal Rashtra Bank to make payment in foreign currency, such receipts towards the amount of the export may be in foreign currency.
  - **From member Countries of ACU (Asian Clearing Union), other than Nepal and Bhutan**

  Such receipts/ payments shall be made through the ACU mechanism or as per the directions issued by the RBI to authorised dealers from time to time.

  However, in case of imports where the goods are shipped to India from a member country of the ACU (other than Nepal and Bhutan) but the supplier is a

resident of a country other than a member country of the ACU, the payment may be made in INR or any foreign currency.

- From countries other than members of ACU

Such receipts/ payments shall be made In Indian Rupees or any foreign currency.

- Transactions other than trade transactions
- For transactions outside of trade activities, all receipts and payments from Nepal and Bhutan are to be conducted in Indian Rupees. However, in the case of overseas investments in Bhutan, payments may also be made in foreign currency.
- Whereas, for transactions involving countries other than Nepal and Bhutan, payments can be made in either Indian Rupees or any foreign currency.
- Further, for any current account transaction, excluding trade transactions, between a resident in India and a person visiting from outside India, payments and receipts in India must be made solely in Indian Rupees.
- These regulations issued by the RBI aim to streamline and regulate the manner of receipt and payment in foreign exchange transactions, ensuring compliance with FEMA Regulations.

CLASSIFICATION OF MSMEs

RBI has issued a circular dated 28 December 2023 issuing amendments in the "Master Direction - Lending to Micro, Small & Medium Enterprises (MSME) Sector" dated 24 July 2017.

The circular emphasises that the classification or re-classification of MSMEs is the statutory responsibility of the Ministry of MSME, GoI, in accordance with the provisions of the MSMED Act, 2006. Specific amendments are being made in para 2.2 of Master Direction, which states that enterprises are required to register online on the Udyam Registration portal and obtain the 'Udyam Registration Certificate.' For Priority Sector Lending (PSL) purposes, banks should adhere to the classification recorded in the Udyam Registration Certificate (URC). Additionally, para 2.4 to 2.7 of the Master Direction has been deleted, indicating a significant update to the Master Direction.

BASEL III FRAMEWORK ON LIQUIDITY STANDARDS - NET STABLE FUNDING RATIO (NSFR) - REVIEW OF NATIONAL DEVELOPMENT BANKS

RBI has issued a notification dated 29 December 2023, regarding the Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSFR) – Review of National Development Banks. NABARD, NHB and SIDBI were considered as National Development Banks (NDBs) under the extant NSFR Framework. By the above notification, It has been decided that the other All India Financial Institutions (AIFIs) i.e. EXIM Bank and National Bank for Financing Infrastructure and Development (NaBFID) shall also be considered as National Development Banks (NDBs) for NSFR computation.

Further, unencumbered loans to NDBs with a residual maturity of one year or more would qualify for a 35 per cent or lower risk weight under the Standardised Approach for credit risk shall be assigned a Required Stable Funding (RSF) factor of 65 per cent as against 100 per cent currently.

This circular is applicable to all Scheduled Commercial Banks (excluding Payments Banks and Regional Rural Banks).

These instructions shall come into force with immediate effect, i.e. 29 December 2023.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

REVISED FRAMEWORK FOR COMPUTATION OF NET DISTRIBUTABLE CASH FLOW (NDCF) BY REAL ESTATE INVESTMENT TRUSTS (REITS)

SEBI vide circular dated 6 December 2023, introduced a revised framework for the computation of Net Distributable Cash Flow (NDCF) by Real Estate Investment Trusts (REITs). Regulation 18(16) of SEBI (Real Estate Investment Trust) Regulations, 2014 (REIT Regulations), provides that the Net Distributable Cash Flow (NDCF) shall be computed at the REIT and HoldCo/SPV levels, with a minimum distribution requirement of 90 per cent.

In order to promote Ease of Doing Business, it has been decided to standardise the framework for the calculation of available Net Distributable Cash Flows. Accordingly, the revised framework for computation of NDCF by REITs and its Holdcos/SPVs shall be as per Annexure A of this circular.

Annexure A includes detailed computations for NDCF at both the HoldCo/SPV and Trust levels. It covers various aspects, including cash flows, proceeds from real estate investments, finance costs, debt repayment, and the creation of reserves.

Further, the Trust along with its SPVs needs to ensure that a minimum 90 per cent distribution of NDCF is met for a given financial year on a cumulative periodic basis as specified for mandatory distributions in the REIT regulations.

It also addresses surplus cash considerations, outlining scenarios as follows:

- 10 per cent of NDCF withheld in line with the Regulations in any earlier year or half year or

- Such surplus being available in a new SPV on the acquisition of such SPV by REIT

Any other reason, excluding if such surplus cash is available due to any debt raise could be considered for distribution by the SPV to the REIT, or by the Trust to its Unitholders in part or in full, but needs to be disclosed separately in the NDCF computation and Distribution.

Similarly, any restricted cash should not be considered for NDCF computation by the SPV or REIT (e.g. unspent CSR balance for any year deposited in a separate account as per Companies Act which will be utilised in subsequent years, DSRA reserve, major maintenance reserve etc)

It provides that no trust or SPVs can distribute any cashflows by obtaining external debt. (this will exclude any working capital / OD facilities obtained by Trust/ SPVs as part of Treasury management / working capital purposes as long as they are squared off within the quarter).

It is also clarified that Proceeds from the sale of real estate investments, real estate assets or shares of SPVs or Investment Entity adjusted for transaction costs or repayment of debt taken for such assets or other items which are intended to be reinvested or planned to be reinvested as per Regulation 18(16)(d) of REIT Regulations, could be temporarily parked in Overdraft accounts or used to repay any additional/ unrelated debt. Further, if such proceeds are not intended to be reinvested as per the timeline provided in the Regulations and such net proceeds are to be distributed back to Unitholders, then redrawing such temporarily parked funds to distribute such net proceeds will not be considered as a contravention.

Cash flows received from SPVs / Investment entities which represent distributions of NDCF computed as per relevant framework at the Trust level for further distribution to Unitholders shall exclude any such cash flows used by the Trust for onward lending to any other SPVs / Investment entities to meet operational / interest expenses or debt servicing of such other SPVs / Investment entities. Capital expenditures include amounts incurred and paid towards asset enhancement and are capitalised to asset value in the financial statements including lease payments. It is further clarified that Existing Assets as referred to in this line item include any new structure/building/ other infrastructure constructed on an existing real estate asset which is already a part of the REIT.

The aforesaid revised framework shall be applicable with effect from 1 April 2024 and supersedes the Framework for calculation of Net Distributable Cash Flows provided in Paragraph F of Chapter 3 of the Master Circular for Real Estate Investment Trusts (REITs) dated 6 July 2023.

REVISED FRAMEWORK FOR COMPUTATION OF NET DISTRIBUTABLE CASH FLOW (NDCF) BY INFRASTRUCTURE INVESTMENT TRUSTS (INVITS)

SEBI vide circular dated 6 December 2023, introduced a revised framework for the computation of Net Distributable Cash Flow (NDCF) by Infrastructure Investment Trusts (InvITs).

Regulation 18(6) of SEBI (Infrastructure Investment Trust) Regulations, 2014 (InvIT Regulations), provides that the Net Distributable Cash Flow (NDCF) shall be computed at the level of InvIT and HoldCo/SPV, with a minimum distribution requirement of 90 per cent.

In order to promote Ease of Doing Business, it has been decided to standardise the framework for the calculation of available Net Distributable Cash Flows. Accordingly, the revised framework for computation of NDCF by InvITs and its Holdcos/SPVs shall be as per Annexure A to the circular.

Annexure A includes detailed computations for NDCF at both the HoldCo/SPV and Trust levels. It covers various aspects, including cash flows, proceeds from real estate investments, finance costs, debt repayment, and the creation of reserves.

Further, Trust along with its SPVs needs to ensure that a minimum 90 per cent distribution of NDCF is met for a given financial year on a cumulative periodic basis as specified for mandatory distributions in the InvIT regulations.

It also addresses surplus cash considerations, outlining scenarios as follows:

- 10 per cent of NDCF withheld in line with the Regulations in any earlier year or half year or
- Such surplus being available in a new SPV on the acquisition of such SPV by InvIT
- Any other reason, excluding if such surplus cash is available due to any debt raise could be considered for distribution by the SPV to the InvIT, or by the Trust to its Unitholders in part or in full, but needs to be disclosed separately in the NDCF computation and Distribution.

Further, any restricted cash should not be considered for NDCF computation by the SPV or InvIT (e.g. unspent CSR balance for any year deposited in a separate account as per Companies Act which will be utilised in subsequent years, DSRA reserve, major maintenance reserve etc)

It provides that no trust or SPVs can distribute any cashflows by obtaining external debt. (this will exclude any working capital / OD facilities obtained by Trust/ SPVs as part of Treasury management / working capital purposes as long as they are squared off within the quarter). It is also clarified that Proceeds from the sale of infrastructure investments, infrastructure assets or shares of SPVs or Investment Entity adjusted for transaction costs or repayment of debt taken for such assets or other items as mentioned above which is intended to be reinvested or planned to be reinvested as per Regulation 18(7) of InvIT Regulations, could be temporarily parked in Overdraft accounts or used to repay any additional/ unrelated debt. Further, if such proceeds are not intended to be reinvested as per the timeline provided in the Regulations and such net proceeds are to be distributed back to Unitholders, then redrawing such temporarily parked funds to distribute such net proceeds will not be considered as a contravention.

Cash flows received from SPVs / Investment entities which represent distributions of NDCF at the Trust level for further distribution to Unitholders shall exclude any such cash flows used by the Trust for onward lending to any other SPVs / Investment entities to meet operational / interest expenses or debt servicing of such other SPVs / Investment entities.

Capital expenditures include amounts incurred and paid towards asset enhancement and are capitalised to asset value in the financial statements including lease payments. It is further clarified that Existing Assets as referred to in this line item include any new structure/building/ other infrastructure constructed on an existing infrastructure asset which is already a part of the InvIT.

The aforesaid revised framework shall be applicable with effect from 1 April 2024 and supersedes the Framework for calculation of Net Distributable Cash Flows provided in Paragraph F of Chapter 3 of the Master Circular for Infrastructure Investment Trusts (InvITs) dated 6 July 2023.

PRINCIPLES OF FINANCIAL MARKET INFRASTRUCTURES (PFMIS)

SEBI vide circular dated 19 December 2023 addressing the Principles of Financial Market Infrastructures (PFMIs) SEBI, as a member of IOSCO, is committed to adopting and implementing the CPSS-IOSCO Principles for Financial Market Infrastructures (FMIs). The PFMIs, comprising 24 principles, aim to fortify the global financial market infrastructure against financial shocks.

The PFMIs are applicable to systematically important FMIs, including Central Counterparties (CCP), Central Securities Depository (CSD)/Securities Settlement System (SSS), Payment and Settlement Systems (PSS), and Trade Repository (TR). These entities play a vital role in the clearing, settlement, and recording of monetary and other financial transactions.

Depositories and Clearing Corporations are regulated by SEBI, categorising them as systemically important FMIs. Compliance with PFMIs is mandatory for these entities to ensure the safety, soundness, and efficiency of the market. SEBI emphasises the self-assessment of FMIs against PFMIs, classified as quantitative and qualitative. The periodicity includes quarterly quantitative assessments and annual qualitative disclosures. FMIs will be monitored annually by the Regulatory Oversight Committee (ROC), with reports submitted to the governing board of the FMI and SEBI within 60 days from the end of the financial year.

This circular is set to be effective from the quarter ended December 2023 and signifies a comprehensive approach by SEBI to enhance the safety, efficiency, and transparency of the financial market.

FRAMEWORK ON SOCIAL STOCK EXCHANGE (SSE)

SEBI vide circular dated 28 December 2023, issued modifications in the framework for the Social Stock Exchange (SSE) which was notified by SEBI, through its Circular dated 19 September 2022. It includes the following:

Minimum requirement to be met by Not-for-Profit Organisations (NPOs)

The circular prescribes the prerequisites for NPOs aiming to register with SSE. This involves providing a Registration Certificate to be valid for at least the next 12 months under sections 12A/12AA/12AB/10(23C)/10(46) of the Income-tax Act, 1961.

  - Further, details regarding pending notices or scrutiny cases from all regulatory and statutory authorities shall be disclosed at the time of making the application for the registration including fines or penalties if imposed shall be disclosed as paid or appealed within 7 days.
  - Further, it specifies Holding a valid 80G registration under the Income Tax Act, 1961, for entities registered under sections 12A/12AA/12AB of the Income-tax Act, 1961 and the entity is required to ensure disclosure regarding the availability of tax deduction to investors.

- Procedure for public issuance of Zero Coupon Zero Principal Instruments by a not-for-profit organisation
  - The circular specifies a procedure for the public issuance of Zero Coupon Zero Principal Instruments by not-for-profit organisations (NPOs) which includes filing the draft fundraising document with the Social Stock Exchange where it is registered along with the fees and an application seeking in-principle approval for listing of its Zero Coupon Zero Principal Instruments on the Social Stock Exchange.
  - The draft fundraising document shall be made available on the website of the Social Stock Exchange and the not-for-profit organisation for a period of at least 21 days for public comments.
  - The Social Stock Exchange shall provide its observation on the draft fundraising document to the not-for-profit organisation within a time period of 30 days from the filing of the draft fundraising document or receipt of clarification, if any, sought by the Social Stock Exchange from not for profit organisation whichever is later.
  - The not-for-profit organisation shall incorporate the observations of the Social Stock Exchange in a draft fundraising document and file the final fundraising document to the Social Stock Exchange prior to opening the issue.
  - The draft fundraising document and the final fundraising document must encompass all essential disclosures that are both truthful and sufficient to empower applicants to make well-informed decisions.
  - Furthermore, and without limiting the scope of the above provision, the draft fundraising document and the final fundraising document shall incorporate disclosures as specified by the Board from time to time. It is citable that the Social Stock Exchange retains the authority to prescribe additional disclosures for both the draft fundraising document and the final fundraising documents.

This circular represents a significant milestone in shaping the landscape of fundraising for Not-for-Profit Organisations (NPOs). With an emphasis on truthful and sufficient disclosures, the SSE aims to foster informed decision-making. The framework, backed by record-keeping and procedural norms, reflects a commitment to ensuring the integrity and effectiveness of the SSE platform.

REGULATORY UPDATES

RESERVE BANK OF INDIA (RBI)

CIRCULAR DATED 11 DECEMBER 2023: SOVEREIGN GOLD BOND (SGB) SCHEME 2023-24

RBI has issued guidelines for the application and issuance of Series 3 and 4 of the Sovereign Gold Bonds Scheme 2023-24 which was announced by the Government of India vide its Notification dated 8 December 2023.

The date of Subscription for Series III is 18/12/2023 – 22/12/2023 and for Series IV is 12/02/2024 – 16/02/2024. After, the subscription, the date of issue of the acknowledgement is 28/12/2023 for Series III and 21/02/2024 for Series IV.

Subscription for SGB may close by CG with prior notice, at any time before the above-mentioned period. Such subscription may be made in the prescribed application form, Form A, stating the units (in grams) of gold and the full name and address of the applicant along with their PAN details.

CG has authorised Designated SCBs and Post offices, Stock Holding Corporation of India Ltd, Clearing Corporation of India Ltd, NSE and BSE to receive applications for bonds and such receiving Offices shall issue an acknowledgement receipt in Form B to the applicant.

All online applications should be accompanied by the email ID of the investor/s which should be uploaded on the Ekuber portal of RBI.

Receiving Offices shall provide services to the investors of the SGB and are required to be guided by the instructions issued by the RBI for dealing with all the procedural aspects and providing service to the investors.

CIRCULAR DATED 12 DECEMBER 2023: PROCESSING OF E-MANDATES FOR RECURRING TRANSACTIONS

RBI vide a circular dated 16 June 2022, has provided a relaxation in Additional Factor of Authentication (AFA) while processing e-mandates / standing instructions on cards, Prepaid Payment Instruments and Unified Payments Interface, wherein the limit for such transactions was set to be INR 15,000. Recently, as per the Circular dated 12 December 2023 and the Statement on Development and Regulatory Policies dated 8 December 2023, the limit for such transactions has been increased from INR 15,000 to INR 1,00,000 per transaction for the following categories:

- Subscription to mutual funds
- Payment of insurance premiums
- Credit card bill payments.

CIRCULAR DATED 19 DECEMBER 2023: INVESTMENTS IN ALTERNATIVE INVESTMENT FUNDS (AIFS)

RBI, vide this circular, has barred regulated entities (REs) from having an investment exposure in units of AIFs which have / would have a downstream investment in the REs' debtor entities.

If an AIF scheme, in which RE is already an investor: -

- Makes a downstream investment in any such debtor company, then the RE shall liquidate its investment in the scheme within 30 days from the date of such downstream investment
- Currently holds a downstream investment in any such debtor company, then the RE shall liquidate its investment in the scheme within 30 days from issuance of this circular.

In case where RE is not able to liquidate the investment in the units of AIF, a 100% provision shall be made in respect of such investment in its books. Further, investment by REs in the subordinated units of any AIF scheme with a 'priority distribution model' shall be subject to full deduction from RE's capital funds.

CIRCULAR DATED 20 DECEMBER 2023: TOKENISATION OF CARDS THROUGH CARD ISSUING BANKS ENABLED BY RBI

In order to enable tokenisation through a single and convenient process, RBI has enabled the tokenisation of cards through card-issuing banks, subject to the following requirements –

- Generation of tokens for a card to be enabled through Internet and mobile banking
- Tokenisation is to be done only on explicit customer consent and with Additional Factor of Authentication (AFA) validation, for example, OTP validation.
- Tokens generated shall be made available on the merchant's payment page.
- Cardholder may opt for tokenisation at any time
- The card issuer shall provide a complete list of merchants for whom it can provide tokenisation services
- Card token may be issued by the card issuer card network or both.

CIRCULAR DATED 22 DECEMBER 2023: REVERSE REPO TRANSACTIONS – REPORTING IN FORM 'A' RETURN

RBI, via the above circular, has revised paragraph B contained in a previously issued circular dated 16 October 2023.

RBI has exempted commercial banks from filing the concerned Form A in cases where such banks enter into reverse repo transactions with non-banks and the original tenor is up to 14 days. In cases where the original tenor of such transactions with non-banks is more than 14 days, transactions must be reported under Item VI(a) of Form A

CIRCULAR DATED 29 DECEMBER 2023: BASEL III FRAMEWORK ON LIQUIDITY STANDARDS – NET STABLE FUNDING RATIO (NSFR) – REVIEW OF NATIONAL DEVELOPMENT BANKS

The NSFR is a significant component of the Basel III reform which ensures a reduction in funding risk over a longer time horizon by requiring banks to fund their activities with sufficiently stable sources of funding in order to mitigate the risk of future funding stress.

Vide the above highlighted Circular, RBI has decided that EXIM Bank and National Bank for Financing Infrastructure and Development shall be considered as National Development Banks (NDBs) for NSFR computation. Further, unencumbered loans to NDBs with a residual maturity of one year or more that would qualify for a 35 per cent or lower risk weight under the Standardised Approach for credit risk shall be assigned a Required Stable Funding factor of 65 per cent (as against 100 per cent currently).

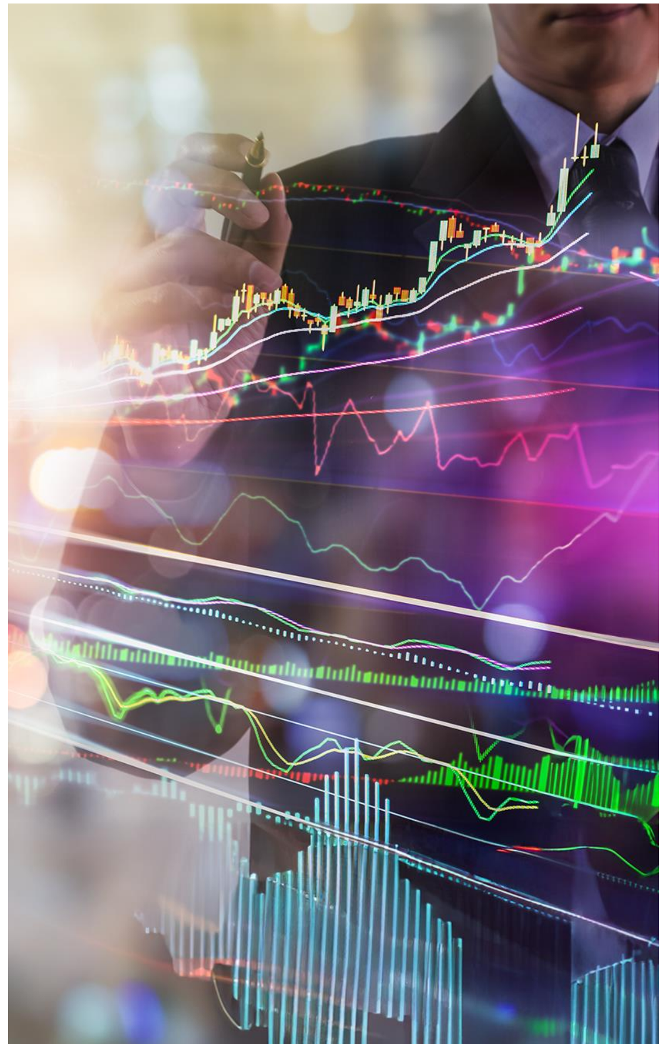
Further select amendments have been made to Circular dated 17 May 2018: Basel III Framework on Liquidity Standards – Net Stable Funding Ratio (NSFR) – Final Guidelines

CIRCULAR DATED 29 DECEMBER 2023: FAIR LENDING PRACTICE - PENAL CHARGES IN LOAN ACCOUNTS: EXTENSION OF TIMELINE FOR IMPLEMENTATION OF INSTRUCTIONS

As per the RBI, the intent of levying penal interest/charges is to inculcate a sense of credit discipline and such charges are not meant to be used as a revenue enhancement tool over and above the contracted rate of interest. However, it had been observed that many Regulated Entities (REs) used penal rates of interest, over and above the applicable interest rates, in case of defaults / non-compliance by the borrower with the terms on which credit facilities were sanctioned.

Hence, RBI vide Circular dated 18 August 2023 has issued certain instructions to the REs with respect to the levying of penal charges to ensure reasonableness and transparency in disclosure of penal interest. The said instructions were to come into effect from 1 January 2024.

However, considering that certain clarifications and additional time have been sought by some REs to reconfigure their internal systems and operationalise the circular, RBI has decided to extend the timeline (in respect of all fresh loans) for implementation of the instructions by three months that is with effect from 1 April 2024. In the case of existing loans, the switchover to the new penal charges regime is to be ensured on or after 1 April 2024, but not later than 30 June 2024.



SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

CIRCULAR DATED 27 DECEMBER 2023: EXTENSION OF TIMELINES FOR PROVIDING 'CHOICE OF NOMINATION' IN ELIGIBLE DEMAT ACCOUNTS AND MUTUAL FUND FOLIOS (CIRCULAR NO. SEBI/HO/MIRSD/POD-1/P/CIR/2023/193)

SEBI has extended the last date for submission of 'choice of nomination' for Demat accounts and mutual fund folios to 31 December 2023 vide Circular No. SEBI/HO/IMD/IMD-I POD1/P/CIR/2023/160 which is further extended to 30 June 2024, vide this circular.

Further, SEBI has asked all the relevant parties, viz., Depository Participants, AMCs and RTAs, to share communication with all demat account holders/ mutual fund unit holders to update/add nominations to their accounts.

The provisions contained in this circular shall come into force immediately.

CIRCULAR DATED 28 DECEMBER 2023: FRAMEWORK ON SOCIAL STOCK EXCHANGE (SSE)

Following the public feedback on SEBI's existing Framework for charitable organisations (NPO) to raise funds from the public, SEBI issued the circular to amend the existing Framework to provide for the following:

- Minimum Requirements to be met by an NPO for registration with SSE
  - Registration certificate under section 12A/12AA/12AB/10(23C)/10(46) of the IT Act along with eligibility of investors for tax deduction under section 80G of the IT Act.
  - Disclosure of all pending notices and scrutiny cases from all regulatory and statutory authorities#
  - Disclosure of fines and penalties (whether paid or not) within 7 days of application.

  #Where pending notices/scrutiny cases endanger the registration of NPOs under the IT Act, SSE may refuse registration.
- Social Impact Reporting and Public Issuance of Zero Coupon Zero Principal Instruments (ZCZPI) by NPO

  The past social impact should highlight trends in key metrics relevant to the NPOs (as determined by the Exchanges) for which it seeks to raise funds on SSE.

  Further, the Circular introduces guidelines for public issuance of ZCZPI, to outline the procedure for issuance and contents of the Fund-Raising Document. It also provides for the conditions for issuance of ZCZPI as below:
  - ZCZPI shall be in dematerialised form and shall not be transferable until expiry.
  - Minimum issue size to be INR 50 lakhs, with minimum application size per ZCZPI being INR 10,000.
  - Minimum subscription required to be 75%.

  The provisions contained in this circular shall come into force immediately.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

CIRCULAR DATED 20 DECEMBER 2023: AMENDMENT TO CIRCULAR DATED 31 JULY 2023, ON ONLINE RESOLUTION OF DISPUTES (ODR) IN THE INDIAN SECURITIES MARKET

- As per the Circular, SEBI on 20 December 2023 amended the master circular on online dispute resolution and some of the key amendments are summarised below -
  - It has included a clarification in Clause 2 to include "institutional/corporate clients" after the words Investors/Clients under the ambit of ODR.
  - It has further included under Clause 3 that the seat and venue of mediation, conciliation and/or arbitration of Dispute shall be in India and can be conducted online. The fees, charges and costs for the independent mediation institution or independent conciliation institution and/or independent arbitration institution (and of the mediators/conciliators/arbitrators), and other applicable costs, charges and expenses may be as prescribed by such institution/s or as agreed upon by the parties with such institution/s.
  - Entities that obtain registration from SEBI as an intermediary or issuers that are getting their securities listed on or after the date of implementation of this circular, are required to enrol in the ODR Portal immediately upon grant of registration or listing, as the case may be.
  - It has modified slabs for arbitrator's fees for claims above INR 50 lakh.
  - In addition to the above, various other amendments are made relating to procedures.
  - The Circular has been issued to protect investor interests and regulate the securities market.
  - The circular shall come into force with immediate effect.

CIRCULAR DATED 11 DECEMBER 2023: CREDIT OF UNITS OF ALTERNATIVE INVESTMENT FUNDS (AIFS) IN DEMATERIALISED FORM, (CIRCULAR)

Pursuant to SEBI Circular dated 21 June 2023 w.r.t mandatory dematerialisation of units issued by AIFs, SEBI has further issued this Circular which lays down a process to be followed by AIFs for dematerialising/ crediting units issued to the investors who are yet to provide demat account details. The Circular has come into immediate effect and broadly the process includes:

- AIF to open Aggregate Escrow Demat Account (Escrow A/c) and credit existing/ new units issued by AIF to such Account.
  - When investor provides demat account details, AIF shall transfer their units to their respective demat account within 5 working days.
- AIF managers shall maintain investor-wise KYC details of units held in Escrow A/c which shall also be reported to Depositories and Custodians on a monthly basis.

- AIFs with corpus ≥ INR 500 Crore shall credit units:
  - Issued to investors (on-boarded prior to 1 November 2023) who have not provided their demat account details, into Escrow A/c latest by 31 January 2024.
  - Already issued to investors who have provided demat account details into their respective demat account, not later than 31 January 2024.
- AIFs with corpus < INR 500 Crore and AIFs launched after 31 October 2023, shall credit units:
  - Issued to their investors who have not provided their demat account details (by 30 April 2024), into Escrow Demat A/c latest by 10 May 2024.
  - Issued by AIFs (as of 30 April 2024) to investors who have provided demat account details into their respective demat accounts, not later than 10 May 2024.

The Circular also states that AIFs adopt implementation standards for investors who are yet to provide demat account details and facilitate conversion and credit of their units in demat form.

CIRCULAR DATED 1 DECEMBER 2023: EXTENSION OF TIMELINE FOR IMPLEMENTATION OF PROVISIONS ON REDRESSAL OF INVESTOR GRIEVANCES THROUGH THE SEBI COMPLAINT REDRESSAL (SCORES) PLATFORM AND LINKING IT TO THE ONLINE DISPUTE RESOLUTION PLATFORM

SEBI had issued a "Circular SEBI/HO/OIAE/IGRD/CIR/P/2023/156" dated 20 September 2023 related to the workflow of processing of investor grievances by entities. Framework for monitoring and handling of investor complaints by designated bodies was required to come into force with effect from 4 December 2023.

Further, the designated bodies referred to in Schedule II of the "Circular SEBI/HO/OIAE/IGRD/CIR/P/2023/156" dated 20 September 2023 were required to apply for SCORES Authentication and/ or for API integration with SCORES so as to ensure their compliance with provisions of the circular by 4 December 2023.

The effective date of implementation of above said provisions has been extended to April 01, 2024. The above Circular shall rescind the Master circular on the redressal of investor grievances through the SCORES platform. The entities shall however submit the Action Taken report on SCORES within 21 calendar days from date of receipt of complaint as directed in the Circular.

DIRECT TAX

CIRCULARS / NOTIFICATIONS / PRESS RELEASE

CBDT EXTENDS THE TIMELINE FOR PROCESSING TAX RETURNS WITH REFUND CLAIMS FOR FISCAL YEAR (FY) 2017-18, 2018-19 AND 2019-20

As per the provisions of Section 143(1) of the Income Tax Act, 1961 (IT Act), the tax return is to be processed and intimation for the same is to be sent within 9 months from the end of the fiscal year (FY) in which the tax return is made.

Central Board of Direct Taxes (CBDT) has observed that due to certain technical issues or for other reasons not attributable to the taxpayers, several tax returns for FYs 2017-18, 2018-19 and 2019-20, which were otherwise filed validly under section 139 or 142(1) or 119 of the IT Act, could not be processed under section 143(1) of IT Act. In order to mitigate genuine hardship, recently, the CBDT has extended the timeline for processing and sending intimation of returns with refund claims for FYs 2017-18, 2018-19 and 2019-20 to 31 January 2024. The returns for these FYs can now be processed with prior approval of the Principal Chief Commissioner of Income Tax/ Chief Commissioner of Income Tax.

However, the aforementioned relaxation shall not be applicable to the following tax returns:

- Returns selected in scrutiny
- Returns remain unprocessed, where either demand is shown as payable in the return or is likely to arise after processing it
- Returns remain unprocessed for any reason attributable to the taxpayer.

[F. No.225/132/2023/ITA-II, dated 1 December 2023]

INCOME-TAX RETURN FORMS NOTIFIED FOR FY 2023-24

The CBDT has notified the income-tax return (ITR) Form 1 and 4 for FY 2023-24 i.e. Assessment Year (AY) 2024-25. These forms are primarily applicable to individuals. No changes have been made to the applicability of the forms i.e. the form to be used by a taxpayer to file the Income-tax return for AY 2024-25 will be same as applicable for AY 2023-24. The key changes made in the newly notified ITRs are as follows:

- Under the newly notified ITRs, the new tax regime under section 115BAC of the IT Act shall now be the default tax regime. This is in line with the amendment made by the Finance Act, 2023. Taxpayer having income (other than income from a business or profession) and filing ITR-1 is only required to indicate their choice of tax regime in the return of income. However, a taxpayer having income from a business or profession and filing ITR-4 will be required to file Form 10-IEA to opt out of the new tax regime.
- A new column was added to claim deduction under section 80CCH of the IT Act[1].
- New column of ‘Receipts in Cash’ has been added to ITR-4 to claim an enhanced turnover limit of INR 3 crores and INR 75 lakhs under sections 44AD and 44ADA respectively.

[Notification No. 105/2023, dated 22 December 2023]

CBDT ISSUES TDS GUIDELINES AND CERTAIN CLARIFICATIONS FOR E-COMMERCE OPERATORS

Section 194-O of the IT Act provides that an e-commerce operator[2] is required to deduct tax (TDS) for the sale of goods or provision of services made by an e-commerce

[1] As per section 80CCH of IT Act, individuals enrolled in the Agnipath Scheme and subscribing to the Agniveer Corpus Fund on or after 01-11-2022 will be eligible for a tax deduction for the total amount deposited in the Agniveer Corpus Fund.

[2] e-commerce operator means a person who owns, operates or manages digital or electronic facility or platform for electronic commerce.

participant[3] which is facilitated by such an e-commerce operator through its digital facility. Section 194-O (4) of the IT Act empowers the CBDT to issue guidelines for removing difficulties in reference to the interpretation and applicability of the provisions. In this regard, CBDT in the past had issued guidelines and provided clarification on several aspects[4]. However, owing to representations received to provide further clarifications, recently, the CBDT has issued a Circular and provided additional guidelines. To read our detailed analysis, please Direct Tax Alert - CBDT issues additional guidelines on TDS by E-Commerce operators under section 194-O of the IT Act – BDO

[Circular No. 20/2023, dated 28 December 2023]

JUDICIAL UPDATES

SUPREME COURT RULES ON THE MEANING OF THE TERM 'MARKET VALUE' FOR SECTION 80IA OF THE IT ACT; REQUIREMENT OF OPTING FOR DEPRECIATION METHOD SATISFIED IF THE SAME IS CLAIMED IN TAX RETURN FORM

The taxpayer, a public limited company, is engaged in the business of generation of electricity, manufacture of sponge iron, M.S. Ingots etc. Since the electricity supplied by the State Electricity Board (SEB) was inadequate to meet the requirements of its industrial units, the taxpayer set up captive power-generating units to supply electricity to its industrial units. Surplus power was supplied by the taxpayer to the SEB at a pre-agreed price which was lower than the price at which it supplied electricity to its other units. The taxpayer claimed a deduction under Section 80 IA of the IT Act with respect to revenue earned from the supply of electricity. The tax return filed by the taxpayer showed NIL income under normal provisions of the IT Act but paid tax on book profits. The tax officer took the value at which the taxpayer supplied the electricity to SEB as market value and thereby denied deduction under section 80IA of the IT Act for the differential amount (i.e. price at which the taxpayer supplied the electricity to its other unit and the price at which it supplied to SEB). The First Appellate Authority concurred with the Tax Officer's view. However, the Tax Tribunal and High Court granted a deduction under section 80IA of the IT Act on the differential amount. Aggrieved, the tax officer filed a Special Leave Petition before the Hon'ble Supreme Court (SC). Before the SC, apart from what constitutes the market, there are three additional issues raised. One of them is, whether filing of tax return is sufficient compliance for opting depreciation rate.

The Hon'ble Supreme Court, while ruling in favour of the taxpayer made the following observations:

- Section 80IA (8) of the IT Act provides that where goods or services held for the purposes of eligible business are transferred to any other business carried on by the taxpayer, the price charged for such transfer should correspond to the market value of such goods or services as on the date of transfer. If the price of goods or services transferred is overstated in comparison to the market value, the tax officer has the competence to recompute the profit by substituting the market value of such goods.
- As per Black's Law Dictionary, 10th Edition, "open market" means a market in which any buyer or seller may trade and in which prices and product availability are determined by free competition. P. Ramanatha Aiyer's Advanced Law Lexicon has also defined the expression "open market" to mean a market in which goods are available to be bought and sold by anyone who cares. Prices in an open market are determined by the laws of supply and demand.
- "Market value" is an expression which denotes the price of a good arrived at between a buyer and a seller in the open market i.e., where the transaction takes place in the normal course of trading. Such pricing is unfettered by any control or regulation; rather, it is determined by the economics of demand and supply.
- The price for the supply of electricity by the taxpayer to the SEB was fixed at INR 2.32 per unit as per the contract. This price is, therefore, a contracted price. Further, there was no room for negotiation on the part of the taxpayer. Under the statutory regime in place, the taxpayer had no other alternative but to sell or supply the surplus electricity to SEB. Being in a dominant position, the SEB could fix the price to which the taxpayer really had little or no scope to either oppose or negotiate. Therefore, it is evident that the determination of tariff between the taxpayer and the SEB cannot be said to be an exercise between a buyer and a seller in a competitive environment or in the ordinary course of trade and business i.e., in the open market. Such a price cannot be said to be the price which is determined in the normal course of trade and competition.
- If the industrial units of the taxpayer did not have the option of obtaining power from the captive power plants of the taxpayer, then in that case it would have to purchase electricity from the SEB. In such a scenario, the industrial units of the taxpayer would have purchased power from the SEB at the same rate at which the SEB supplied to the industrial consumers i.e., INR 3.72 per unit.
- Therefore, it is clear that the rate at which power was supplied to a supplier could not be the market rate of electricity purchased by a consumer in the open market. On the contrary, the rate at which the SEB supplied power to the industrial consumers (INR 3.72 per unit) has to be taken as the market value for computing deduction under Section 80 IA of the IT Act.
- Revenue's reliance on the decision of the Calcutta High Court in ITC Ltd[5] does not apply to the present case since in the case of ITC Ltd, the electricity generated was sold by the taxpayer entirely to its paper unit. There was no surplus electricity to be supplied to the SEB and consequently, there was no contract between the taxpayer and the SEB determining the rate of tariff for the electricity supplied by the taxpayer to the State Electricity Board. It was held by the High Court that the taxpayer's generating unit could not claim any benefit under Section 80-IA of the IT Act computing the profits and gains on the basis of the rate chargeable by the distribution licensee from the consumer and that the benefit could only be claimed on the basis of the rates fixed by the tariff regulatory commission for the sale of electricity by the generating company.

[3] e-commerce participant means a person resident in India selling goods or providing services or both, including digital products, through digital or electronic facility or platform for electronic commerce.

[4] Circular No. 17/2020, dated 29 September 2020.
Circular No. 20/2021, dated 25 November 2021. Please refer our tax alert- https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-cbdt-issues-further-guidelines-on-tax-withholding-from-purchase-of-goods

[5] CIT Vs. ITC Ltd.

Further, on whether there is no requirement under the second proviso to Rule 5(1A) of Income-tax Rules, 1962 (IT Rules) that any particular mode of computing the claim of depreciation has to be opted for before the due date of filing of the tax return. All that is required is that the taxpayer has to opt before filing the tax return or at the time of filing the tax return that it seeks to avail the depreciation provided in Section 32 (1) under Rule 5(1) of IT Rules read with Appendix-I instead of the depreciation specified in Appendix-1A in terms of sub-rule (1A) of Rule 5 which the taxpayer has done.

[CIT v. M/s. Jindal Steel and Power Limited [Civil Appeal No. 13771 of 2015 (Supreme Court)]

DELHI HIGH COURT HOLDS THAT FEES TOWARDS DOMAIN REGISTRATION OF CUSTOMERS ARE NOT 'ROYALTY'

Taxpayer, a US-based company and an accredited registrar for the Internet Corporation for Assigned Names and Numbers (ICANN) is engaged in providing services such as domain name registration, website design and web hosting. The taxpayer charges a fee from its customers for facilitating domain name registration. While part of the fee received from the customers is kept by the taxpayer, a portion of the fee is shared with ICANN and the registry. The taxpayer offers income from web hosting as a Royalty. However, the tax officer proposed to treat web hosting income as Fees for Technical Services and revenue from domain name registration as Royalty under Section 9(1)(vi) of the IT Act as well as Article 12(3)(a) of India-USA Double Tax Avoidance Agreement, and thereby passed draft order. The taxpayer filed objections against the draft order before the Dispute Resolution Panel (DRP), which upheld the draft order. Hence, the taxpayer filed an appeal before the Delhi Income Tax Appellate Tribunal (Delhi Tax Tribunal), which dismissed the taxpayer's appeal. Aggrieved, the taxpayer preferred an appeal with the Delhi High Court (Delhi HC). While holding that the fee received by the taxpayer for registration of domain names of third parties, i.e., its customers, cannot be treated as royalty, the Delhi HC made the following observations:

- The taxpayer's stand that it has no ownership rights in the domain name registered by it is demonstrable from the agreement entered into between the taxpayer and ICANN (Accreditation Agreement). As per the agreement, the taxpayer has given up exclusive ownership or use of data elements. Clause 3.5 of the agreement clearly establishes that the taxpayer who acts as a Registrar and, in that capacity, provides domain registration services to its customers does not have any proprietorship rights in the domain name.
- In accordance with the agreement entered into between the taxpayer and the customer, it is established that mere registration of a domain name does not create any proprietorship rights in the name used as the domain name or in the domain name registration either in the taxpayer or the customers or even any other third party.
- Since the taxpayer is not the domain name's owner, it cannot confer the right to use or transfer the right to use the domain name to another person/entity.
- Delhi Tax Tribunal's reliance on the Hon'ble SC's decision in Satyam Infotech[6] was misconceived. The Hon'ble SC in Satyam Infotech was concerned only with the rights of the domain name owner and not the Registrar while determining whether passing off action can be initiated in relation to domain names. In this case, however, the taxpayer is only acting as a Registrar and thus offering its services to its customers for having their domain names registered. This principle may have been attracted if the taxpayer had granted rights in or transferred the right to use its domain name, i.e., Godaddy.com, to a third person.

[Godaddy.com LLC vs DCIT, International Taxation (New Delhi) [(2023) ITA No. 75/2023 (Delhi)]

MUMBAI TAX TRIBUNAL HOLDS THAT REFUND TO BE ADJUSTED FIRST ON THE INTEREST COMPONENT AND THEN ON THE PRINCIPAL COMPONENT; INTEREST ON A TAX REFUND IS TO BE COMPUTED UP TO DATE OF ACTUAL RECEIPT OF THE REFUND

The taxpayer, principal investment holding company and promoter of Tata companies, had filed NIL tax return for FY 1992-93 on 31 December 1993. An Order Giving Effect (OGE) to the Mumbai Tax Tribunal was passed on 8 March 2016 wherein a refund of INR 304 million was determined. However, the taxpayer received the said refund on 18 August 2022. As there was short credit of interest, the taxpayer filed an appeal before Mumbai Tax Tribunal. The grievances of the taxpayer were as follows:

- Improper adjustment of refunds
- Failure to calculate interest for the interim period i.e. from the date of OGE to the date of actual receipt of refund
- Failure to calculate interest under section 244A(1A)[7] of the IT Act.

While ruling in favour of the taxpayer, the Mumbai Tax Tribunal made the following observations:

Re. Adjustment of the refund issued under section 244A of the IT Act

- The tax officer is required to first adjust the interest component and then the taxes for the purpose of calculating interest under section 244A[8] of the IT Act.
- Reliance was placed on the Grasim Industries Ltd[9] case wherein the ratio laid down was that the amount of interest under section 244A of the IT Act is to be calculated by first adjusting the amount of refund already granted towards the interest component and balance left, if any, shall be adjusted towards the tax component. Shortfall should then be considered for the purpose of computing further interest payable to the taxpayer under section 244A of the IT Act till the date of grant of such refund.

[6] Satyam Infoway v. Siffynet Solutions, (2004) 6 SCC 145

[7] When there is a delay in granting refund due to the taxpayer as a result of delay in passing an order giving effect to the appellate order or revisional order, the taxpayer is entitled to the additional interest on such amount of refund at 3% p.a.

[8] Where refund of any amount becomes due to the taxpayer under the IT Act, he shall, subject to the provisions of this section, be entitled to receive, in addition to the said amount, simple interest calculated in the prescribed manner.

[9] Grasim Industries Ltd vs DCIT (123 taxmann.com 312)

Re. Computation of interest till the date of actual receipt of refund

- Relying on the decisions of the Bombay High Court in the case of Pfizer Limited[10], City Bank NA Mumbai[11] and K.E.C International[12], the Mumbai Tax Tribunal held that the taxpayer is justified in seeking interest under section 244A of the IT Act up to the date of receipt of the refund order.

Re. Additional interest under section 244A(1A) of IT Act

- The provisions of sub-section 244A(1A) are inserted by the Finance Act, 2016 as a remedial measure to compensate the taxpayer in cases where there are delays in granting refunds due on account of delay in passing OGE to appellate or revisional orders. As per the ratio laid down by the Mumbai Tax Tribunal in the case of Bharat Petroleum Corporation Ltd[13], Section 244A(1A) of the IT Act would apply prospectively and hence additional interest would be eligible only from 1 June 2016 till the date of actual receipt of refund.

[Tata Sons Private Limited [I.T.A. No. 2362/Mum/2023) (Mumbai Tax Tribunal)]

[10] CIT vs. Pfizer Limited [1991] 191 ITR 626 (Bom)
[11] ITA No. 6 of 2001
[12] CIT vs. K.E.C International in ITA No. 1038 of 2000
[13] ACIT v/s Bharat Petroleum Corporation Ltd. (Mumbai ITAT) (ITA No. 5231 to 5233 of 2019)

INDIRECT TAX

ITC IS REQUIRED TO BE REVERSED IN CASE A RETURN IS FILED BEYOND THE STATUTORY TIME LIMIT PRESCRIBED UNDER SECTION 16(4) OF THE CGST ACT

Facts of the case

- BBA Infrastructure Ltd. (Taxpayer) received a show cause notice alleging wrong availment of Input Tax Credit (ITC) in the returns filed for the period September 2018 to March 2019 on the ground that the said returns were filed beyond the due date prescribed under Section 16(4) of the Central Goods and Services Tax Act, 2017 (CGST Act). The aforesaid SCN was confirmed by the Tax Authorities *vide* the Order-in-Original.
- Concurrently, the Tax Authorities initiated recovery proceedings and debited INR 2.29 million (CGST of INR 1.16 million and SGST of INR 1.13 million) from the Electronic Credit Ledger balances along with interest which was debited from the Electronic Cash Ledger balances.
- Against the aforementioned Order-in-Original, the Taxpayer filed an appeal before the First Appellate Authority, who confirmed the Order-in-Original passed by the Tax Authorities.
- Subsequently, the Taxpayer filed a Writ Petition against the aforesaid order passed by the First Appellate Authority before the Hon'ble Calcutta High Court and *inter alia* sought a consequential direction seeking a refund of the amount recovered by the Tax Authorities in excess of 10% of the disputed tax and also prohibit the Tax Authorities from taking coercive actions against the Taxpayer.
- The Hon'ble High Court, vide an Interim Order dated 13 June 2023 *inter alia* held that there is no scope for passing any interim order in the present matter.
- Aggrieved by the same, the Taxpayer filed an Intra-Court Appeal before the Hon'ble High Court.

Contentions by the Taxpayer

- As per the first proviso to Section 16(2) of the CGST Act, ITC is not claimed through the return but is taken through books of accounts immediately on receipt of goods and services. Thus, the time limit under Section 16(4) of the CGST Act cannot supersede or override the scheme of the statute *inter alia* including the non-obstante provision of Section 16(2) of the CGST Act.
- Section 16(2) of the CGST Act has an overriding effect on Section 16(4) as is evident from the phrase used in the statute viz., 'entitled to take credit'. Hence, the entitlement of a particular right after fulfilling the prescribed conditions results in a right and 'taking' or 'availing' or 'utilising' that right through procedural formalities or furnishing a return is a matter of choice.
- There is no mention of any time limit under Section 16(1) of the CGST Act. Further, there is no visible linkage between the provisions of Sections 16(1) and 16(4) of the CGST Act.
- Further, the time limit for filing the monthly return from April 2019 to June 2019 was extended (*vide* Notification no:12/2019 dated 7 March 2019). In addition to the above, late fees payable for delayed filing of GST returns during the period July 2017 to September 2018 were waived (*vide* Notification no:76/2018-Central Tax dated 31 December 2018).

Contentions by the Tax Authorities

- As the Taxpayer has filed Form GSTR-3B beyond the statutory time limit provided under Section 16(4) of the CGST Act, the Taxpayer is not eligible to claim ITC, and hence, must reverse the same. Further, since the Taxpayer had wilfully misstated the particulars and wrongly availed the ITC benefit, the Taxpayer is also liable to pay a penalty.

- The statute should be interpreted while considering the entire text and exception clauses or *non-obstante* clauses should not be interpreted in isolation from the main enacting provision.
- *Non-obstante* clause is employed to override some contrary provision but not complementary provision. The language of Section 16 of the CGST Act is clear that the non-obstante clause in Section 16(2) does not in any manner limit the operation of Sections 16(3) or 16(4) and they are not contradicting, rather they are complementing each other.
- On a joint reading of Sections 16(2)(d) and 16(4) of the CGST Act, it appears that the eligibility to claim ITC arises after the filing of a return under Section 39 of the CGST Act. This condition is further qualified by imposing a time limit under Section 16(4) of the CGST Act.
- Further, the imposition of penalty in the present case is justified because the Taxpayer had committed fraud by making false and dishonest representation in Form GSTR-3B return and claimed ineligible ITC thereby reducing the net tax liability.

Observations and Ruling by the Hon'ble High Court

- The Hon'ble Andhra Pradesh High Court (in ***Thirumalakonda Plywoods Vs. The Assistant Commissioner, State Tax [2023-VIL-472-AP]***) had held that Section 16(2) of the CGST Act prescribes the eligibility criteria which is mandatory and in the absence of fulfilment of the eligibility criteria, the dealer will not be entitled to claim ITC.
- Relying on the aforesaid decision, the contention that the *non-obstante* clause in Section 16(2) of the CGST Act overrides Section 16(4) of the CGST Act is rejected. Further, it was held that Section 16(2) of the CGST Act does not appear to be a provision which allows ITC, rather Section 16(1) of the CGST Act is the enabling provision and Section 16(2) of the CGST Act restricts the claim of ITC which is otherwise allowed to taxpayers satisfying the prescribed conditions.
- Further, in ***Gobinda Construction & Ors. Vs. Union of India & Ors. [TS-455-HC(PAT)-2023-GST],*** it was held that the right to claim ITC under Section 16(1) of the CGST Act is only vested if the conditions for claiming ITC, including those under Section 16(4) of the CGST Act, are fulfilled. Section 16(4) of the CGST Act cannot be said to be violative of Article 300A of the Constitution of India.
- In view of the above, the Intra-Court Appeal as well as the Writ Petition filed by the Taxpayer were dismissed.

BBA Infrastructure Ltd. Vs. Senior Joint Commissioner of State Tax & Ors. dated 14 December 2023, [TS-646-HC(CAL)-2023-GST]

AMAZON'S ECHO DEVICES ARE CLASSIFIABLE AS COMMUNICATION DEVICES UNDER CTH 8517 AND HENCE, ENTITLED TO THE BENEFIT OF EXEMPTION

Facts of the case

- M/s. Amazon Wholesale India Pvt. Ltd. (Taxpayer) had sought an advance ruling to determine whether the subject devices[1] were classifiable under CTH 8517, 8518 or 8528 and thus eligible for exemption under Notification 57/2017-Cus dated 30 June 2017.
- The Authority for Advance Ruling (AAR) held as under:
  - **Classification of products:**
    - The principal function of the three Echo 4th generation devices is the reproduction of sound, and hence, they should be classified as speakers. While these devices may be voice-enabled and compatible with a Wi-Fi environment, these features would lead one to recognise them as 'smart speakers' classifiable under CTH 8518 2200. Similarly, Echo Studio Device which is *akin* to the '4th generation device' is classifiable under CTH 8518 2200.
    - The primary function of Echo Show Devices is to act as a display/monitor, thus, enabling playback of videos from web channels, to display video content during video calling and viewing motion pictures. Hence, they are classifiable as monitor/display not incorporating television reception apparatus under CTH 8528 5900.
    - Echo Flex being a communication device is classifiable under CTH 8517 6290.
    - The principal function of Echo link is that of reception, conversion and transmission of voice or other data to the high-quality speaker and since the amplifier functions embedded in the device were not a principal feature, it is classifiable under CTH 8517 6290. Similarly, the Echo Link Amplifier, being similar to the Echo Link device, is classifiable under CTH 8517.
  - **Eligibility to claim exemption:**
    - As regards the eligibility to claim the benefit of exemption as per Notification no: 47/2017-Cus. dated 30 June 2017 (Exemption Notification), the AAR observed that the qualifying criteria for claiming exemption are that the devices are classifiable under CTH 8517 6290 or 8517 6990 coupled with the condition of those devices not falling in the list of excluded items enumerated therein (which *inter alia* included Multiple Input Multiple Output (MIMO) devices).
    - Accordingly, the AAR observed that only Echo Auto and Echo Flex would qualify for the exemption in terms of the Exemption Notification. The remaining devices were not eligible to claim the benefit of exemption under the Exemption Notification.
- Aggrieved by the above, the Taxpayer filed an appeal before the Hon'ble Delhi High Court.

[1] Echo 4th Generation, Echo Studio Device, Echo Dot 4th Generation, Echo Dot 4th Generation with Clock, Echo Show 5, Echo Show 8, Echo Show 10, Echo flex, Echo Auto, Echo Link and Echo Link Amp

Contentions by the Taxpayer

- The subject devices are essentially mediums of communication with built-in Alexa technology. While the devices do not support cellular services, they are designed to be connected with wired / external Wi-Fi.
- The subject devices are pre-programmed to commence functioning on the use of the *wake word* 'Alexa' using the inbuilt microphone to detect that particular sound. The instructions or commands orally conveyed and so captured by the subject devices constitute the data which is thereafter transmitted over the internet to the Amazon Server/Alexa Voice Server (AVS).
- Note 3 to Section XVI provides guidance for classification by stipulating that in the case of multi-functional machines, the principal function of the machine would be determinative of the classification of goods.
- The subject devices should be acknowledged as being *'convergence devices'* and thus, classifiable under CTH 8517 6290 which extends to machines for reception, conversion and transmission or regeneration of voice, images or other data.
- Reliance was also placed on Circular dated 5 September 2013 wherein the CBIC had considered the various features of Bluetooth Wireless headsets and held that they would be classified under CTH 8517. Applying the above, the classification of the subject goods would need to be evaluated based on the well-settled 'principal function' test.
- Further, the name or nomenclature of a product cannot always be accepted to be a valid criterion for classification in complete disregard to the functionality of a product. Accordingly, merely because the subject devices may be advertised as 'smart speakers' would not determine the classification of the devices.
- The AAR erred in holding that if the subject devices were not connected to the internet, they would function as speakers only. The said view is taken in ignorance of the fact that the subject devices are in fact designed, manufactured and intended to be used with an internet connection failing which the various Alexa-based features which are embedded in those devices would be rendered otiose.

Contentions by the Tax Authorities

- The principal function of the speaker is to act as a speaker or as a display or monitor. The Amazon Echo 4th generation devices and the Amazon Echo Show devices are being marketed and sold as a premium speaker and a monitor, respectively. In common trade parlance, they are not regarded as Alexa-based communication devices and therefore, would not be classified under CTH 8517.
- The subject devices are devoid of cellular network services and modem and do not have the necessary capabilities to function as communication devices as compared to similarly placed devices that may legitimately claim placement under CTH 8517.
- The Echo 4th generation devices and the Echo Studio accepting voice commands with Wi-Fi capability would at best qualify as 'smart speakers' and those devices would be classifiable as 'hearable speakers' as per Notification no:12/2022-Customs dated 1st February 2022.

Observations and Ruling by the Hon'ble High Court

- The AAR erred in failing to appreciate the well-settled principle that the name or nomenclature as ascribed to a particular product may not and in all circumstances be countenanced to be the determinative or conclusive test in so far as the issue of classification is concerned.
- The Hon'ble Supreme Court in ***Commissioner of Customs, Central Excise and Service Tax Vs. Sarvotham Care [2015 (13) SCC 498]*** and ***Commissioner of Customs, Central Excise and Service Tax, Hyderabad Vs. Ashwani Homeo Pharmacy [TS-192-SC-2023-EXC]*** held that the nomenclature alone would not constitute a defining basis for the purpose of answering a question of classification.
- Various tests have been evolved by the Courts such as nomenclature, common parlance, principal function, and primary and incidental purpose to determine the classification of a product and the same should be considered cumulatively to determine the true character of the product.
- The soul of these devices was their ability to act as means for transmission and reception of data, the devices when working in a Wi-Fi environment enabling the user to perform a multitude of tasks, the recognition of voice commands and interact with AVS in real teams. Each of these facets constitutes the core ability of the subject devices compelling one to acknowledge this capability as constituting the principal component of the machine with the said features being its principal function.

- CTH 8518 was confined to loudspeakers *per se* while CTH 8528 stood basically confined to displays and monitors generally. These entries cannot be construed to extend their coverage to convergence devices or platforms which were designed and enabled to perform the function of transmission and reception of voice or data or performance of the varied functions which constituted the special characteristics of the subject devices.
- The unique features of the products in question make them principally designed to act as mediums for data reception and transmission and as an aside also be used as a speaker. Therefore, they can be classified as communication devices under CTH 8517.
- Since these devices perform various functions, including data reception, conversion and transmission, they meet the requirements for classification under CTH 8517. The fact that they can also be used as speakers cannot change their primary attribute to be that of a speaker alone.
- In view of the above, the subject devices would be classified under CTH 8517 and hence, eligible to claim the benefit of exemption as per the Exemption Notification.

  Amazon Wholesale India Pvt. Ltd. Vs. Customs Authority of Advance Ruling dated 11 December 2023, [TS-634-HC-2023(DEL)-CUST]

CESTAT ALLOWS DUTY REMISSION ON GOODS DESTROYED IN FIRE IN THE SEZ UNIT

Facts of the case

- ONGC Petro Additions Ltd. (Taxpayer) has a SEZ unit situated in Bharuch, Gujarat. In this unit, a fire broke out which resulted in the imported raw materials being destroyed by fire (Imported Raw Materials).
- In this regard, the Taxpayer filed an application for remission of duty in respect of Imported Raw Materials. However, the said application was rejected vide the Impugned Order, *inter alia* on the following grounds:
  - Remission of duty in respect of SEZ unit would be governed by the Special Economic Zones Act, 2005 (SEZ Act) which overrides the provisions of all other legislations including Section 23 of the Customs Act, 1962 (Customs Act).
  - The Taxpayer failed to take proper precautions to avoid the fire incident.
  - The Taxpayer, while taking the insurance policy has obtained insurance only for the principal value of goods and has not obtained insurance for the Customs duty component.
- Aggrieved by the above, the Taxpayer filed an appeal before CESTAT.

Contentions by the Taxpayer

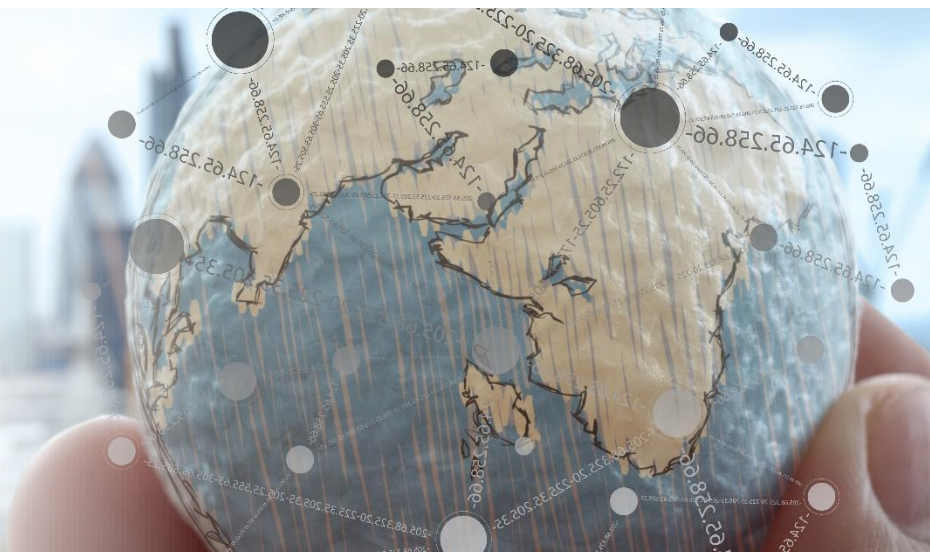
- The provisions of the SEZ Act have an overriding effect over other legislations only in cases where the provisions under the other legislation are inconsistent with the provisions of the SEZ Act. In the present case, since the levy of Customs Duty is governed by the provisions of the Customs Act, the remission of Customs Duty would also be governed by the Customs Act. Further, Section 23 of the Customs Act is not inconsistent with the provisions of the SEZ Act and hence, the question of overriding effect of the SEZ Act would not arise in the present case.
- On perusal of the survey report, it is evident that the fire incident has taken place suddenly and beyond the control of the Taxpayer. Further, there was no carelessness or negligence on the part of the Taxpayer, and hence, the fire incident could not be avoided.
- Further, the insured value of the Imported Raw Materials was done without including the Customs duty component on the basis of the invoice value on which, the levy of Customs duty did not exist. The insurance company will not insure an amount which does not form part of the value of goods. Hence, the Taxpayer has rightfully insured the only value of the goods. Reliance in this regard was placed on various judicial precedents[2].

Observations and Ruling of the CESTAT

- The survey report indicates that there was no negligence on the part of the Taxpayer as the fire broke out suddenly beyond the Taxpayer's control. Therefore, the allegation that the Taxpayer did not take proper precautions to avoid the fire incident is baseless.
- An extensive survey was conducted by the survey officer for the insurance purpose. However, the Customs Department did not conduct any inspection or analysis to conclude their findings that the Taxpayer has not taken any precaution. Therefore, the claim that the Taxpayer was negligent in the fire accident cannot be accepted.
- Since the assessment of Customs duty is done under the Customs Act, the provision concerning remission of customs duty would automatically be applicable. Only those provisions of other legislations which are inconsistent with the provisions of the SEZ Act would not apply. Since the grant of remission under Section 23 of the Customs Act does not contradict any provisions of the SEZ Act, the argument that Section 23 of the Customs Act is inapplicable is not valid.
- The Taxpayer is only liable to insure the value of the goods and not the Customs duty. If the invoice contains any taxes or duties, obviously the gross value inclusive of all these elements shall be taken for the purpose of insurance. However, in the case of SEZ, when the goods are imported and entered into SEZ, the value of goods remains the only principal value and since no Customs duty was payable, the question of inclusion of duty would not arise. Non-inclusion of customs duty component for insurance purposes cannot be a reason to deny the remission of duty.
- In view of the above, the Impugned Order is set aside, and the appeal is allowed.

  ONGC Petro Additions Ltd. Vs. CC- Ahmedabad dated 11 December 2023, [TS-641-CESTAT-2023-CUST]

[2] M/s. Satguru Polyfab Pvt. Ltd. Vs. CC, Kandla [2011 (267) ELT 273 (Tri-Ahmd)], M/s. Jindal International Vs. CC, Kandla [2013 (290) ELT 729 (Tri-Ahmedabad)], Sami Labs Ltd. Vs. The Commissioner of Customs [2007 (2) TMI 518 - CESTAT, Bangalore] and State of Haryana Vs. Dalmia Dadri Cement Ltd. [2004 (178) ELT 13 (SC)]



TRANSFER PRICING

ASSESSMENT ORDER PASSED PURSUANT TO DRP DIRECTIONS LACKING COMPUTER GENERATED DIN, IS DEEMED INVALID DUE TO NON-COMPLIANCE WITH CBDT CIRCULAR NO. 19/2019 REQUIREMENTS

In the said batch of appeals, multiple taxpayers received assessment orders based on directions from the Dispute Resolution Panel (DRP) without a valid computer-generated Document Identification Number (DIN). They raised this issue before the Hon'ble Income Tax Appellate Tribunal (ITAT), asserting that DRP directions lacking a valid DIN rendered the assessment orders invalid. The Revenue argued that a valid DIN was subsequently generated and separately communicated to the taxpayers, complying with CBDT Circular No. 19/2019. However, the ITAT, after considering the relevant facts and arguments, made the following key observations:

- ***Scope of CBDT Circular No. 19 / 2019***

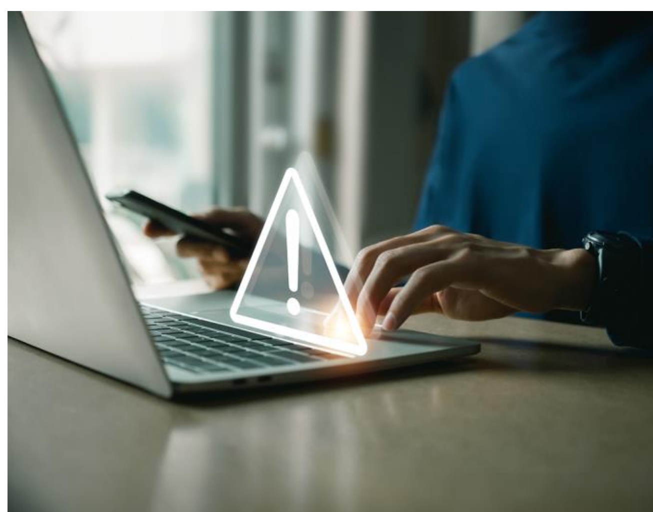
With the launch of various e-governance initiatives, the Income-tax Department is moving toward total computerisation of its work, and this has led to a significant improvement in the delivery of services and brought greater transparency in the functioning of the tax administration. Thus, ITAT highlighted that the issuance of the Circular mandating the generation of DIN was crucial for maintaining a systematic audit trail. Further, CBDT circulars are binding in nature for all income-tax authorities.

- ***Validity of Handwritten DIN***

It was observed that computer-generated DINs were either absent from the body of the order or replaced with manually written DINs. Upon verification, these hand-generated DINs showed an error, indicating 'no record found for the given document number.' The absence of DINs in communications necessitates approval by a competent authority. Additionally, manual communications must include a reference number, and the date of approval by the concerned officer, and adhere to a specified format outlined in the Circular. Thus, ITAT dismissed Revenue's arguments regarding handwritten DINs, stating that retroactively generating a DIN and manually inserting it into the order does not fulfil the stipulated conditions of the CBDT Circular.

- ***Integration between the Income Tax Business Application (ITBA) portal and DRP Module***

It was noted that the Income Tax Department's field officers had the capability to assign and include DINs on all communications to taxpayers, regardless of whether these documents were generated through online platforms like AST/ITD applications or prepared manually. Thus, ITAT rejected the Revenue's argument that the lack of integration between the ITBA portal and the DRP module prevented the generation of DINs when the orders were passed.

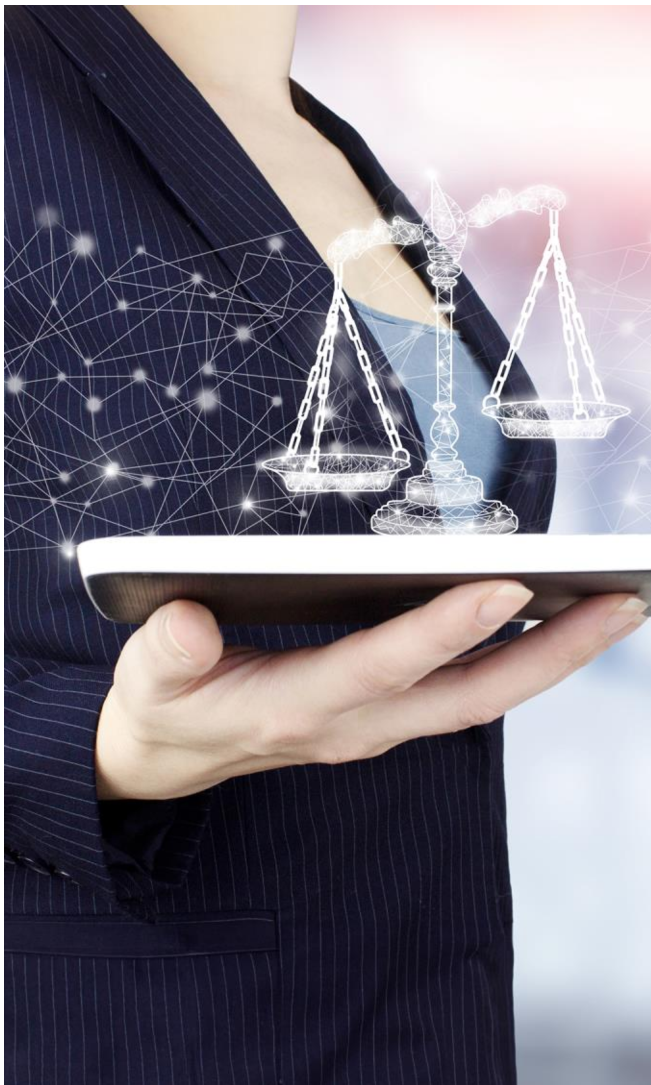


- *Other Rulings*

ITAT distinguished the Madras High Court (HC) ruling in the case of Texmo Precision Castings[1] by noting that the decision did not specifically address the matter in reference to paragraphs 3 and 4 of Circular No. 19/2019. Instead, the ruling directly addressed paragraph 5 of the Circular, which pertains to the regularisation of orders issued without quoting the DIN. Further, it was noted that no exceptional circumstances as described in para 3 of the Circular are mentioned in the directions issued by the DRP/AO, thus, the Madras HC decision is not applicable. Additionally, it was observed that in a subsequent decision by Madras HC in the Ericsson[2] case, when considering a similar circular in the context of indirect tax laws, the HC held that the absence of generation or allocation of DIN renders the communication invalid.

Accordingly, Hon'ble ITAT held the DRP directions lacking a valid DIN are invalid and deemed to have never been issued. Consequently, the final assessment orders passed pursuant to such invalid DRP directions were quashed.

Sutherland Global & Others [TS-718-ITAT-2023(CHNY)-TP]



HC QUASHES THE FINAL ASSESSMENT ORDER ISSUED BY THE AO AS A CONSEQUENCE OF FAILURE TO FILE A COPY OF THE APPEAL TO DISPUTE RESOLUTION PANEL WITH AO

Tax assessment proceedings for the Assessment Year (AY) 2020-21 were completed and a Draft Assessment Order was passed by the Learned Assessing Officer (AO) (viz. the National Faceless Assessment Centre), wherein an adjustment was proposed to the income disclosed by the taxpayer in its Return of Income.

The taxpayer filed its objections against the aforesaid adjustment before the Hon'ble Dispute Resolution Panel (DRP) as prescribed under Section 144C(2)(b)(i) of the Income-tax Act, 1961 (Act), within the statutory timeline of 30 days from the date of receipt of the Draft Assessment Order. However, the taxpayer inadvertently did not file a copy of the same with the AO, which is prescribed u/s 144C(2)(b)(ii) of the Act. Subsequently, the AO proceeded to issue the Final Assessment Order (Order) based on the Draft Assessment Order, since it was not aware of the objections filed by the taxpayer before the DRP.

In this regard, the taxpayer filed a Writ Petition before the Hon'ble High Court (HC) contesting the validity of the Order issued by the AO, wherein it appealed to the HC to quash /set aside the aforementioned Order along with the computation sheet, demand notice and initiation of penalty proceedings.

The HC observed that the Act mandates the taxpayer to file objections to the Draft Assessment Order before the DRP as well as the AO. However, a meaningful and harmonious interpretation of the said obligation is required. In this regard, the HC noted that if objections are filed with the DRP, the same must result in Directions and the AO has to ultimately complete the Assessment in conformity with the Directions of the DRP, without providing any further opportunity of being heard to the taxpayer. Accordingly, the completion of the assessment proceedings by the AO would happen only after the DRP has perused the objections filed by the taxpayer and has provided its Directions to the AO.

In light of the above, the HC ruled in favour of the taxpayer and quashed the Order along with the computation sheet, demand notice and initiation of penalty proceedings. Further, it restored the matter to the stage u/s 144C (5) of the Act, wherein the DRP would proceed to issue Directions for the guidance of the AO to enable him to complete the assessment after considering the objections of the taxpayer.

Google India Private Limited [TS-723-HC-2023(KAR)-TP]

[1] 288 Taxman 251
[2] Writ Petition No.14776/2020 and WMP No.18358/2020

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