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ACCOUNTING UPDATES

INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA (ICAI)

EAC OPINION

Accounting For Subsidy Receivable Under The Ind AS Framework

Facts of the Case

A Company (hereinafter referred to as 'the Company') is registered under the Companies Act, 1956/2013. The Company is a state government company as the entire equity is held by the State Government. The bonds of the Company are publicly traded on the Bombay Stock Exchange (BSE). The Company has the following 5 subsidiaries, and distribution companies (hereinafter collectively referred to as the DISCOMs):

- Pu Vidyut Vitran Nigam Limited (PuVVNL)
- M Vidyut Vitran Nigam Limited (MVVNL)
- D Vidyut Vitran Nigam Limited (DVVNL)
- P Vidyut Vitran Nigam Limited (PVVNL)
- K Electricity Supply Company Limited (KESCO).

The DISCOMs are also registered under the Companies Act, 1956/2013.

The Company is primarily engaged in the bulk purchase of power from inter-state and intra-state generators and in the bulk sale/supply of power to the DISCOMs. The bulk sale tariff for the sale of power to DISCOMs is decided by the Company. The DISCOMs are engaged in the distribution and supply of electricity to consumers in their specified areas. Tariffs for distribution/supply (including subsidy chargeable/receivable against subsidised consumers) are regulated/approved by the State Electricity Regulation Commission (SERC).

The Company has been receiving grants/ subsidies from the State/Central Government on behalf of the DISCOMs under various schemes, such as the Ujjwal DISCOM Assurance Yojana (hereinafter referred to as UDAY), ATMNIRBHAR Scheme, Revamped Distribution Sector Scheme (RDSS) etc. and subsequently allocates/ transfers it to the respective DISCOMs.

The UDAY scheme was a financial restructuring programme launched by the Government of India in November 2015. The scheme primarily aimed to address the financial health and operational efficiency of DISCOMs in India. The scheme's basic objectives were mainly to reduce the debt burden, to improve operational efficiencies and to promote sustainable energy practices of the DISCOMs. Under this scheme, the State Government took over 75% of the outstanding debt on the books of the DISCOMs as of 30 September 2015. The balance debt i.e. remaining 25% was issued as state government-guaranteed DISCOM bonds. This helped in reducing the interest burden and overall debt of the DISCOMs. The State Government had sanctioned and released a subsidy of INR 29350.32 crores under the UDAY (being 75% of the total outstanding debt of the DISCOMs amounting to INR 39,133.76 crores as on 30 September 2015).

Additional revenue subsidy amounting to INR 39,743.00 crores, which was determined by the SERC (in trueing up of the Tariff for the DISCOMs for the period from financial year (F.Y.) 2007-08 to F.Y. 2019- 20), was payable by the State Government to DISCOMs through the Company. But no accounting has been done on this account in the books of the account of the Company and DISCOMs as there was no reasonable assurance from the State Government in this regard. Later on in the year 2020-21, the State Government, vide its Notification No. 445/24-01-21-731(budget) /2020 dated 5 March 2021, had adjusted the aforesaid revenue subsidy of INR 29,350.32 crores, which was received under UDAY, in the following manner and heads/ item:

S.NO.	PARTICULARS	AMOUNT (INR IN CRORES)
1.	Electricity dues from State Government's departments	4,268.86
2.	Against additional revenue subsidy of INR 39,743.00 crores trued up Tariff for the year 2007-08 to 2019-20	25,081.46
Total		**29,350.32**

After adjustment of the above additional tariff subsidy of INR 25,081.46 crores, the additional tariff of subsidy of INR 14,661.54 crores (INR 39,743.00 crores - INR 25,081.46 crores) remained unadjusted. Apart from this, the balance amount of INR 6,278.47 crores was also payable by the State Government under UDAY for the period from F.Y. 2016-17 to 2019-20. Thus, the total subsidy of INR 20,940.00 crores (INR 14,661.54 crores + INR 6,278.47 crores) was to be received from the State Government for which the State Government had ordered in the aforesaid Notification dated 5 March 2021, that INR 20,940.00 crores shall be paid to the Company/ DISCOMs in the next 10 (Ten) years through budget, which will be utilised/adjusted by the Company to repay the loan (including interest) taken from financial institutions, R Corporation and P Corporation under Aatmnirbhar Yojna. The loan of INR 20,940.00 crores was taken from financial institutions against the above admissible/receivable subsidy of INR 20,940.00 crores from the State Government.

Since the aforesaid subsidy of INR 20,940.00 crores was to be allocated by the Company amongst the DISCOMs, the Company, vide its circular no. 1526 dated 26 October 2021, had allocated the same after making necessary adjustments as tabulated below:

S.NO.	NAME OF DISCOM	TARIFF SUBSIDY	UDAY SUBSIDY	TOTAL AMOUNT (INR IN CRORES)
1	PuVVNL	6,401.50	1,714.04	8,115.54
2	MVVNL	-	978.08	978.08
3	DVVNL	-	2,159.69	2,159.69
4	PVVNL	8,260.03	886.42	9,146.45
5	KESCO	-	540.24	540.24
		14,661.53	**6,278.47**	**20,940.00**

The State Government vide its following orders, has sanctioned/released the subsidy against a total receivable subsidy of INR 20,940/- crores as detailed below:

S.NO.	STATE GOVERNMENT ORDER NO.	SANCTIONED/ RELEASED AMOUNT	YEAR
1	90/2021/1040/24-1- 2021-830 Budget @2021 dated. 05.08.2021	INR 2000 crores	2021- 22
2	111/2022/001-914-24- 1-2022- 830 Budget-2021 dated. 20.07.2022	INR 2000 crores	2022- 23
3	46/2023/001-972-24- 1-2023-830 Budget-2021 dated. 15.04.2023	INR 2000 crores	2023- 24

In the context of the accounting for subsidy of INR 20940.00 crores, the following relevant points/facts are clear in the aforesaid Notification dated 5 March 2021, of the State Government:

- There is a reasonable assurance that INR 20,940.00 crores shall be received from the State Government in the next 10 years from the F.Y. 2021-22.
- The Company shall comply with the conditions after receipt of fund/ amount from the State Government.

In the above context, the following provisions of Ind AS 20, 'Accounting for Government Grants and Disclosure of Government Assistance' are also relevant, which can be referred:

As per Ind AS 20, "Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity…."

"6 Government grants are sometimes called by other names such as subsidies, subventions, or premiums."

"20 A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable."

"22 A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood."

"8 A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attaching to it and that the grant will be received….

9 The manner in which a grant is received does not affect the accounting method to be adopted in regard to the grant. Thus, a grant is accounted for in the same manner whether it is received in cash or as a reduction of a liability to the government."

Accounting Treatment given in books

- For a subsidy of INR 14,661.53 crores

Keeping in view the aforesaid provisions of Ind AS 20 and the fact that the additional tariff subsidy of INR 14661.54 crores relates to an earlier period i.e. 2007-08 to 2019-20, the DISCOMs (PVVNL and PuVVNL) had made the accounting entries in their books of account for the year 2020-21 as tabulated below:

S.N	NAME OF DISCOMS	AMOUNT OF TARIFF SUBSIDY (INR IN CRORES)	DEBIT HEAD OF ACCOUNT	CREDIT HEAD OF ACCOUNT
1	PVVNL	8,260.03	Receivable from the State Government	General Reserve (under other equity)
2	PuVVNL	6,401.50	Receivable from the State Government	Retained Earnings (Accumulated Deficit) (under other equity)

From the year 2021-22 and onwards, the General Reserve Account is being amortised on the basis of actual year-wise receipt of subsidy from the State Government, by debiting to the General Reserve Account/Retained Earning Account/Accumulated Deficit and crediting to Other Income under the Profit and Loss Account.

- For a subsidy of INR 6,278.47 crores

The accounting treatment given by the DISCOMs in the year 2020-21 in respect of a subsidy of INR 6,278.47 crores under the UDAY scheme is as follows:

S.N	NAME OF DISCOMS	AMOUNT OF TARIFF SUBSIDY (INR IN CRORES)	DEBIT HEAD OF ACCOUNT	CREDIT HEAD OF ACCOUNT
1	PuVVNL	1,714.04	Receivable from the State Government	Retained Earning
2	MVVNL	978.08	Receivable from the State Government	Other Income
3	DVVNL	2,159.69	Receivable from the State Government	General Reserve
4	PVVNL	886.42	Receivable from the State Government	General Reserve
5	KESCO	540.24	Receivable from the State Government	Other Income
	Total	**6,278.47**		

From the year 2021-22 and onwards, the General Reserve Account/ Retained Earnings (Accumulated Deficit) is being amortised, on the basis of actual year-wise receipt of subsidy from GoUP, by debiting to General Reserve Account/Retained Earnings (Accumulated Deficit) and crediting to Other Income.

Comment/Observation of Government Supplementary Audit:

- With respect to the accounting for the additional revenue subsidy of INR 14,661.53 crores (as mentioned above), the views as per supplementary audit comments issued on the financial statements of the PVVNL and PuVVNL for the F.Y. 2020-21 are as follows:
  - **PVVNL:**

    The additional revenue subsidy of INR 8,260.03 crores is receivable from the State Government in the next 10 years as per Government Order (GO) dated 5 March 2021, issued by the State Government, which was allocated to PVVNL by the Company vide letter dated 26 October 2021. The amount of subsidy receivable in the next 10 years should have been accounted for as 'Deferred Income' in terms of paragraph 55 of Ind AS 1, which provides for the inclusion of an additional line item in the Balance Sheet. However, the amount of INR 8,260.03 crores receivable from the State Government has been adjusted in the General Reserve instead of booked as Deferred Income. Thus, the incorrect depiction has resulted in an overstatement of the General Reserve and an understatement of Deferred Income by INR 8,260.03 crores each.
  - **PuVVNL:**

    The additional revenue subsidy of INR 6,401.50 crores is receivable from the State Government in the next 10 years as per GO dated 5 March 2021, issued by the State Government, which was allocated to PuVVNL by the Company vide letter dated 26 October 2021. The amount of subsidy receivable in the next 10 years should have been accounted as 'Deferred Income' in terms of paragraph 55 of Ind AS 1, which provides for the inclusion of an additional line item in the Balance Sheet. However, the amount of INR 6,401.50 crores receivable from the State Government has been adjusted in Accumulated Deficit as an adjustment against Reserves and Surplus instead of booking as Deferred Income. Thus, the incorrect depiction has resulted in an understatement of Accumulated Deficit (being negative) and Deferred Income by INR 6,401.50 crores each.
- In respect of the accounting treatment made in accounts for subsidy of INR 6,278.47 crores as mentioned above, the views as per supplementary audit are as follows:
  - The above also includes INR 1,714.04 crores being claim of UDAY Loss subsidy made by PuVVNL in addition to the admissible amount as per the actual loss incurred by it in previous years. As per clause 1.2(i) of the tripartite MoU signed on 30 January 2016 among the Ministry of Power, Government of India (GoI), State Government and the Company (on behalf of all DISCOMs), the admissible period for claim of UDAY loss subsidy has expired in 2020-21. Further, PuVVNL has already accounted for inadmissible UDAY loss subsidy receivable from State Government in its accounts for the year ending up to 2020-21. Hence, the accounting of additional UDAY loss subsidy resulted in an understatement of accumulated deficit (being negative) and an overstatement of Receivable from the State Government by INR 1,714.04 crores.
  - The above includes INR 3,046.10 crores (DVVNL: INR 2,159.69 crores and PVVNL: INR 886.41 crores) being claim of UDAY Loss subsidy made by the Company in addition to the admissible amount as per the actual loss incurred by it in previous years. As per clause 1.2(i) of the tripartite MoU signed on 30 January 2016 among the Ministry of Power, Government of India (GoI), State Government and the Company (on behalf of all DISCOMs), the admissible period for claim of UDAY loss subsidy has expired in the year 2020-21. Further, the Company has already accounted for UDAY loss subsidy receivable from the State Government in its accounts for the year ending 2020- 21. Hence, accounting of additional UDAY loss subsidy resulted into overstatement of General Reserve and Receivables from the State Government by INR 3,036.10 crores.
  - The above includes INR 1,518.32 crores (MVVNL: INR 978.08 crores and KESCO: INR 540.24 crores) being claim of UDAY Loss subsidy made by the Company in addition to the admissible amount as per the actual loss incurred by it in previous years. As per clause 1.2(i) of the tripartite MoU signed on 30 January 2016 among the Ministry of Power, Government of India (GoI), State Government and the Company (on behalf of all DISCOMs), the admissible period for claim of UDAY loss subsidy has expired in 2020- 21. However, the Companies have accounted inadmissible UDAY loss subsidy receivable from State Government in their accounts for the year ending up to 2020-21.

    {The Company's views on above audit comment of INR 6278.47 crores: - If in the supplementary AG's Audit, it had been agreed with the admissibility of the subsidy of INR 6,278.47 crores under UDAY as per State Government's aforesaid notification dated 05-03-2021, the view in the final comments on INR 6278.47 related to UDAY would have been the same as in the case of accounting of the additional revenue subsidy of INR 14,661.54 crores.}
- Government Supplementary Audit comment on Disclosures:

  "It has been disclosed by the Company that as per GO

dated 5 March 2021, of State Government, the subsidy of INR 20,940 crores is receivable from the State Government in favour of DISCOMs through the Company and the same are to be paid by the State Government in the forthcoming 10 years. This amount includes INR 14,661.54 crores being the balance amount of additional revenue subsidy and INR 6,278.46 crores being UDAY loss subsidy. The UDAY loss subsidy was claimed from the State Government in addition to the admissible amount as per actual loss incurred by the DISCOMs in the period ending up to 2020-21. As per the aforesaid GO dated 5 March 2021, the State Government has accepted to provide an additional revenue subsidy of INR 39,743 crores to the DISCOMs for the period 2007-08 to 2019-20 as approved by SERC through its Tariff/True-up Orders issued from time to time. The above GO also provided that, out of a total additional revenue subsidy of INR 39,743 crores, INR 25,081.46 crores shall be deemed to be paid from the grants provided to the DISCOMs by the State Government under UDAY in earlier years. The balance amount of INR 14,661.54 crores shall be paid to the DISCOMs by the State Government in the next 10 years, commencing from 2021-22. The Company vide its letter dated 26 October 2021, has allocated the above additional revenue subsidy as below:

S.NO	NAME OF DISCOM	AMOUNT (INR IN CRORES)
1	M Vidyut Vitran Nigam Limited	3490.00
2	Pu Vidyut Vitran Nigam Limited	12367.00
3	P Vidyut Vitran Nigam Limited	14673.00
4	D Vidyut Vitran Nigam Limited	9213.00
5	K Electricity Supply Company Limited	0.00
	Total	**39743.00**

The facts above being material requiring specific accounting treatment should also have been disclosed in the Notes to the Accounts to enable better understanding of financial information."

Comment/Observation of Statutory Auditors:

The comment of statutory auditors as given in the consolidated financial statements of the Company for F.Y. 2021-22 is as under: "Group has shown **INR 16940.00 crores** subsidy receivable from State Government as Non-Current Assets Note No. 8 towards Atmnirbhar Bharat Scheme which is receivable in 10 years as per G.O. no **445-1-24-731** (Budget)/ 2020 dated 05.03.2021 of State Government. The corresponding amount is credited in "Other Equity" (Retained Earnings). Considering the principle of Revenue Recognition and Ind AS 20, the subsidy should be accounted for on an annual basis based on the budget provision/release subsidy by the State Government. In view of the above, subsidy receivable as mentioned in Non-Current assets is overstated and Other Equity (negative) is understated to that extent."

The Company has mentioned in the above context that the Statutory Auditor has given comment on the subsidy of INR 16,940 crores {non-current assets} instead of INR 20,940 crores as sanction of subsidy of INR 4,000 crores as per the budget of State Government was received before finalisation of consolidated financial statements.

Query

In view of the final comment of the government auditor as well as the comment of the statutory auditor and the different accounting treatment given by the DISCOMs, the Company seeks the opinion of the Expert Advisory Committee of ICAI on the following issues considering the specific facts and circumstances as described above in the Facts of the Case:

- What accounting should have been done by the DISCOMs in the financial year 2020-21 in respect of the subsidy of INR 20,940.00 crores receivable from the State Government?
- Since the accounts of the DISCOMs for the F.Y. 2021-22 and 2022-23 have been finalised, what would be the correct and prudent consequential accounting treatment/adjustment which is to be given in the ensuing accounts in hand, i.e., F.Y. 2023-24.
- In case, any correction is required in the year 2020-21 towards the accounting of subsidy, what would be the necessary disclosure which is required to be given in the financial statements of the Company/ DISCOMs in F.Y. 2023-24.

Points considered by the Committee

The Committee notes that the Company is a State Government Company and is primarily engaged in bulk purchase of power from inter-state and intrastate generators and in bulk sale/ supply of power to the DISCOMs (being its subsidiaries). The tariff for supply of power by DISCOMs to consumers (including subsidy receivable against subsidised consumers) is regulated/approved by the State Electricity Regulation Commission (SERC). The Company has been receiving grants/subsidies from the State Government/Central Government on behalf of the DISCOMs under various schemes and subsequently allocates/transfers it to the respective DISCOMs. The Committee presumes that these grants/subsidies are not given by the government in its capacity of being a shareholder/owner of the Company and instead represent government grants as per Ind AS 20. The Committee notes that the basic issue raised by the Company relates to accounting treatment of INR 20,940 crores subsidy received or receivable in respect of certain grants receivable under Uday Scheme and those under additional tariff/revenue subsidy as per Ind AS 20 by the DISCOMs. The Committee has, therefore, examined only this issue and has not examined any other issue that may arise from the Facts of the Case. The Committee has answered the issue only from an accounting perspective and not from a legal perspective. 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.

The Committee notes the following paragraphs of Ind AS 20:

"Government grants are assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity. They exclude those forms of government assistance which cannot reasonably have a value placed upon them and transactions with the government which cannot be distinguished from the normal trading transactions of the entity.

Grants related to assets are government grants whose primary condition is that an entity qualifying for them should purchase, construct or otherwise acquire long-term assets. Subsidiary conditions may also be attached restricting the type or location of the assets or the periods during which they are to be acquired or held. Grants related to income are government grants other than those related to assets."

From the above, the Committee notes that grants related to assets are those grants whose primary condition is that an enterprise qualifying for them should purchase, construct or otherwise acquire long-term assets and other grants are classified as grants related to income. Thus, in case of grants related to assets, primary condition is the purchase, construction or acquisition of long-term assets.

As per the Facts of the Case, the Committee notes that the main objective of the grants under consideration in the extant case appears to be to provide financial support for the operating activities of the DISCOMs:

- The additional tariff subsidy appears to be in lieu of the revenue foregone in view of the regulated or subsidised price and should be considered as a grant related to income.
- The UDAY scheme is a financial restructuring programme whose basic objectives are to reduce part of the debt burden (by providing subsidies) and improve operational efficiencies rather than acquire any tangible/intangible asset.

Thus, the grants in the extant case are grants related to income.

With regard to the accounting for the grants, the Committee notes the following requirements of Ind AS 20:

"12 Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate."

"17 In most cases the periods over which an entity recognises the costs or expenses related to a government grant are readily ascertainable. Thus, grants in recognition of specific expenses are recognised in profit or loss in the same period as the relevant expenses. Similarly, grants related to depreciable assets are usually recognised in profit or loss over the periods and in the proportions in which depreciation expense on those assets is recognised."

"19 Grants are sometimes received as part of a package of financial or fiscal aids to which a number of conditions are attached. In such cases, care is needed in identifying the conditions giving rise to costs and expenses which determine the periods over which the grant will be earned. It may be appropriate to allocate part of a grant on one basis and part on another.

20 A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity with no future related costs shall be recognised in profit or loss of the period in which it becomes receivable.

21 In some circumstances, a government grant may be awarded for the purpose of giving immediate financial support to an entity rather than as an incentive to undertake specific expenditures. Such grants may be confined to a particular entity and may not be available to a whole class of beneficiaries. These circumstances may warrant recognising a grant in profit or loss of the period in which the entity qualifies to receive it, with disclosure to ensure that its effect is clearly understood.

22 A government grant may become receivable by an entity as compensation for expenses or losses incurred in a previous period. Such a grant is recognised in profit or loss of the period in which it becomes receivable, with disclosure to ensure that its effect is clearly understood."

With respect to timing of recognition of the grant, the Committee also notes the following paragraphs of Ind AS 20:

"7 Government grants, including nonmonetary grants at fair value, shall not be recognised until there is reasonable assurance that:

- The entity will comply with the conditions attached to them; and
- The grants will be received.

8 A government grant is not recognised until there is reasonable assurance that the entity will comply with the conditions attached to it and that the grant will be received. Receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled."

The Committee notes from the Facts of the Case that the Tariff for distribution/supply (including subsidy chargeable/receivable against subsidised consumers) is regulated/approved by the SERC and is a subsidised/concessional price. Thus, the tariff subsidy is not in relation to any specific expense incurred by the DISCOM; rather it appears to be the compensation for the loss of tariff for the DISCOM due to subsidised/concessional tariff (as fixed by the SERC/ government) to be charged to the consumer. Therefore, the subsidy is received in return for compliance with certain conditions including supply of power at subsidised or concessional rates. Accordingly, the Committee is of the view that the tariff subsidy should be recognised in the Statement of Profit and Loss in the period in which the related power is supplied provided there is reasonable assurance of receipt of the grant and compliance of other conditions attached to the subsidy, as per paragraph 7 of Ind AS 20.

The Committee notes that as per the Facts of the Case, the tariff subsidy aggregating to INR 39,743.00 crores for F.Y. 2007-08 to F.Y. 2019-20 was not recognised in the relevant years due to lack of reasonable assurance as required by paragraph 7 of Ind AS 20. In F.Y. 2020-21, the Government Order dated 5 March 2021 determined the tariff subsidy to be INR 14,661.54 crores and this was to be received by the DISCOMs in 10 instalments from F.Y. 2021-22 and of these, 3 instalments have been received.

The Committee is of the view that irrespective of receipt of funds, the tariff subsidy (relating to power already supplied at a concessional rate) should have been recognised in the financial year in the Statement of Profit and Loss with a corresponding cash or asset (subsidy receivable) when the requirements of paragraph 7 of Ind AS 20 were met; in other words, the subsidy should be recognised only as and when there is reasonable assurance that the related criteria are met. As clarified in paragraph 8 of Ind AS 20, mere receipt of a grant does not of itself provide conclusive evidence that the conditions attaching to the grant have been or will be fulfilled. In this regard, the Committee notes that the Company has stated in the context of the amount of subsidy of INR 20,940 crore (which also includes subsidy under the UDAY scheme) that the Company shall comply with the conditions after receipt of fund/amount from the State Government. Thus, it is not clear whether there are any substantive conditions to be complied with in relation to the additional revenue subsidy other than the supply of power. Therefore, if even at the time of receipt of funds, there are pending substantive conditions related to tariff subsidy and the reasonable assurance criteria are not met, the grant should not be recognised and the funds received towards the grant should be recognised as liability (deferred income). However, if there are no substantive conditions related to grants to be complied with and there is reasonable assurance about receipt of grant due to the Order of the State Government in the F.Y 2020-21 (even though funds are not received), the subsidy should be recognised in that financial year in the Statement of Profit and Loss with a corresponding asset (subsidy receivable).

In the above context, the Committee notes that the DISCOMs had recognised tariff receivable in the F.Y. 2020-21 with a corresponding credit to general reserve/retained earnings (which is subsequently being amortised to profit or loss on the basis of actual year-wise receipt of subsidy). As stated above, if the requirements of paragraph 7 were not met, then the recognition of assets was not appropriate. However, if the requirements of paragraph 7 were met and the recognition of the asset was appropriate, the corresponding credit should have been recognised in the Statement of Profit and Loss. The credit to general reserves/retained earnings is not in compliance with Ind AS 20.

As regards the subsidy under the UDAY Scheme, the DISCOMs will receive funds from the State Government (through the Company) which can be used only for discharge of specified outstanding debt. The Committee notes that while it is stated that there is a reasonable assurance that a grant shall be received from the State Government in the next 10 years from the F.Y. 2021-22, it is also stated that the Company shall comply with the conditions after receipts of fund/amount from the State Government. Thus, it appears that the entitlement of a grant under this scheme is subject to various substantive conditions. Therefore, the discussion in paragraph 17 above would also apply for the timing of recognition of the grant under the UDAY Scheme. Thus, if there are pending substantive conditions related to the subsidy and the reasonable assurance criteria are not met, the grant/ subsidy should not be recognised even if the funds have been received; the subsidy should be recognised only when there is reasonable assurance that the required criteria as per Ind AS 20 are met.

In the above context, the Committee notes that some of the DISCOMs had recognised the subsidy receivable in the F.Y. 2020-21 with a corresponding credit to general reserve/retained earnings (which is subsequently being amortised to profit or loss on the basis of actual year-wise receipt of subsidy). As stated above, if the requirements of paragraph 7 were not met, then the recognition of assets was not appropriate. But if requirements of paragraph 7 were met and the recognition of asset was appropriate, the corresponding credit should have been recognised in the Statement of Profit and Loss instead of general reserves/retained earnings.

The Committee is further of the view that in the extant case, since the DISCOMs did not follow the above-mentioned requirements of Ind AS 20, as discussed above,

the same should be rectified in the current reporting period, considering it as an accounting 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 (see paragraphs 42–47).

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

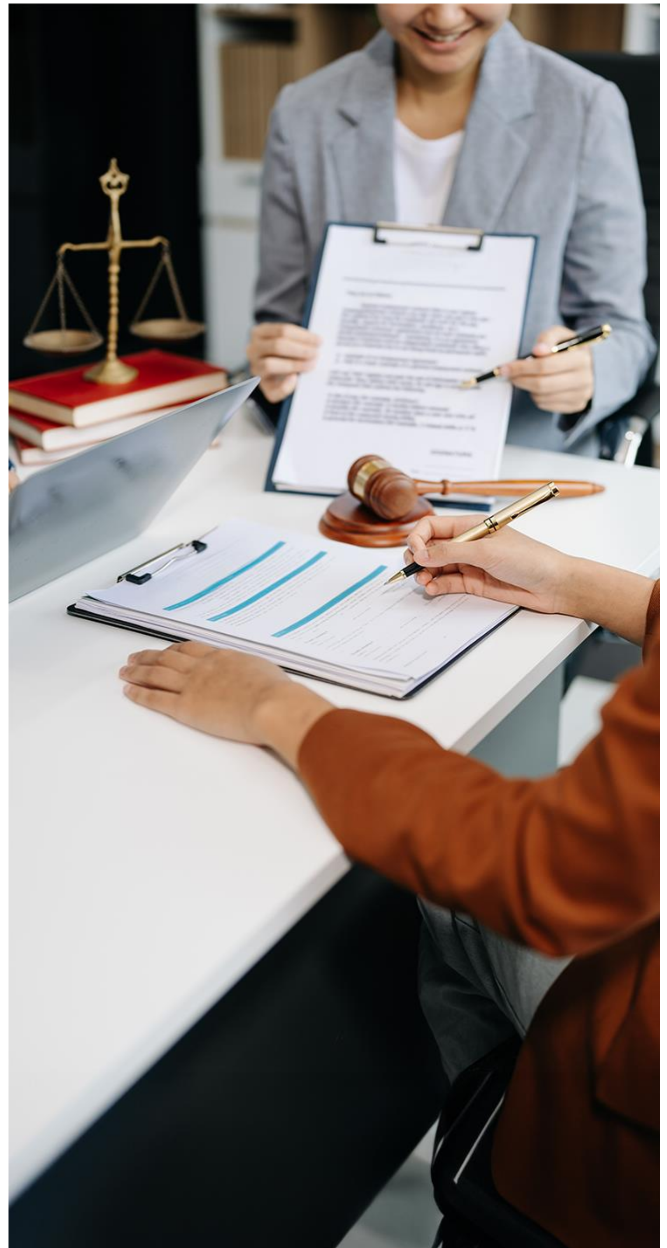
- Restating the comparative amounts for the prior period(s) presented in which the error occurred; or
- If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented."

Thus, in the extant case, the DISCOMs shall correct material prior period errors retrospectively in the current reporting period, i.e., F.Y. 2023-24 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, by restating the opening balances of assets, liabilities and equity for the earliest prior period presented. Further, necessary disclosures as per the requirements of Ind AS 8 (paragraph 49) and Ind AS 1, 'Presentation of Financial Statements' (including presentation of a third balance sheet at the beginning of the preceding period) should be made.

Opinion

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

- Refer paragraphs above on the tariff for distribution and supply.
- Since the DISCOMs did not follow the requirements of Ind AS 20, as discussed above, the same should be rectified in the current reporting period, i.e., F.Y. 2023-24 considering it as an accounting error, as per the requirements of Ind AS 8, as discussed above.
- For necessary disclosures, refer to the requirements of Ind AS 8 and Ind AS 1.



REGULATORY UPDATES

Institute of Chartered Accountants of India (ICAI)

Audit Quality Maturity Model Version 2.0

The Council of ICAI has approved the Audit Quality Maturity Model version 2.0 (AQMM v 2.0). AQMM v 1.0 has been mandatory since 1 April 2023, for the firms auditing the following:

- A listed entity or
- Banks other than co-operative banks (except multi-state co-operative banks) or
- Insurance Companies

However, firms conducting only branch audits are not covered here. AQMM v 2.0 has the same applicability criteria as AQMM v 1.0 and therefore it is also mandatory for firms auditing the aforementioned entities. The firm's level, as determined by AQMM v 1.0, is reviewed by a peer reviewer and recorded on ICAI's website against the validity of the firm's peer review certificate.

AQMM v 2.0 has three sections, and its scoring pattern is as follows:

SECTION REFERENCE	MAXIMUM SCORE	%WEIGHTAGE
a) Practice Management – Assurance	370	61.67
b) Human Resource Management	150	25.00
c) Digital competency	80	13.33
	600	100.00

To facilitate a smooth transition from the previous version, AQMM v 2.0 will apply to firms which submit Form 1 – Application cum Questionnaire on or after 1 April 2025. This applies to firms with a review period from 1 April 2022 to 31 March 2025 (excluding firms constituted during this period for which the review period will start from the date of the constitution till 31 March 2025). However, they have the option to adopt AQMM v 2.0 earlier.

LEVEL	SCORES RECEIVED	
	GREATER THAN OR EQUAL TO	LESS THAN
Level 1 Firm	30%	50%
Level 2 Firm	50%	70%
Level 3 Firm	70%	85%
Level 4 Firm	85%	100%

To facilitate a smooth transition from the previous version, AQMM v 2.0 will apply to firms which submit Form 1 – Application cum Questionnaire on or after 1 April 2025. This applies to firms with a review period from 1 April 2022 to 31 March 2025 (excluding firms constituted during this period for which the review period will start from the date of the constitution till 31 March 2025). However, they have the option to adopt AQMM v 2.0 earlier.

MINISTRY OF CORPORATE AFFAIRS (MCA)

Companies (Adjudication Of Penalties) Amendment Rules, 2024

MCA vide notification dated 5 August 2024, has issued amendments to the Companies (Adjudication of Penalties) Rules, 2014 with the insertion of Rule 3A on “Adjudication Platform”.

As per Sub Rule 1 of Rule 3A, on commencement of the Companies (Adjudication of Penalties) Amendment Rules, 2024, all proceedings of the adjudicating officer and Regional Director including the issue of notices, filing replies or documents, evidence, holding of hearing, attendance of witnesses, passing of orders and payment of penalty shall take place in electronic mode only through an e-adjudication platform developed by the Central Government.

Further as per Sub Rule 2 of Rule 3A, in case the e-mail address of any person to whom a notice or summons is required to be issued under these rules is not available, the adjudicating officer shall send the notice by post to the last intimated address or the address available in the records and the officer shall preserve a copy of such notice in the electronic record in the e-adjudication platform referred to in sub-rule (1). In case no address of the person concerned is available, the notice shall be placed on the e-adjudication platform.

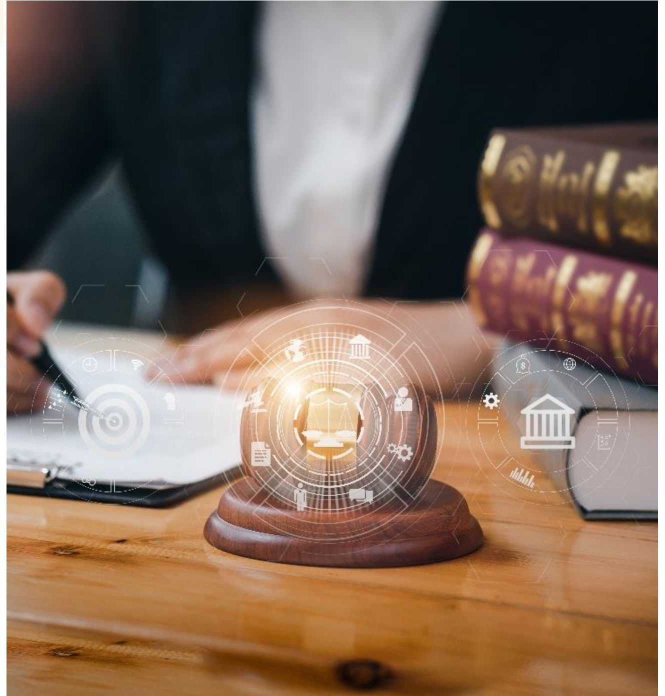
Also, the Annexure to the said rules has been substituted by an Annexure which includes Form No. ADJ for ‘Memorandum of Appeal’.

These Rules shall come into force from 16 September 2024.

Limited Liability Partnership (Amendment) Rules, 2024

MCA vide notification dated 5 August 2024, has issued Limited Liability Partnership (Amendment) Rules, 2024. This brought amendments to Rule 37 of Limited Liability Partnership Rules, 2009 with respect to striking off names of defund LLPs with inclusion of reference to Centre for Processing Accelerated Corporate Exit established by the Central Government, empowering it to strike off the names of defunct LLPs along with Registrar which will streamline the exit process of such LLPs.

These Rules shall come into force from 27 August 2024.



Companies (Registration of Foreign Companies) Amendment Rules, 2024

MCA vide notification dated 12 August 2024, has issued amendments to the Companies (Registration of Foreign Companies) Rules, 2014. This amendment substitutes the word, “registrar” with “Registrar, Central Registration Centre” in Rule 3(3), and a proviso is inserted in Rule 8(1), mandating that the documents for registration by a foreign company shall be delivered in Form FC-1 to the Registrar, Central Registration Centre.

These Rules shall come into force from 9 September 2024.

Companies (Indian Accounting Standard) Amendment Rules, 2024

The Central Government, in consultation with the National Financial Reporting Authority (NFRA), amended the Companies (Indian Accounting Standards) Rules, 2015 vide notification dated 12 August 2024.

MCA has introduced a new Indian Accounting Standard Ind AS 117, “Insurance Contracts” replacing current standard Ind AS 104, “Insurance Contracts”. Ind AS 117 establishes principles for recognising, measuring, presenting and disclosing insurance contracts with the objective of aligning these requirements with global standards.

In addition, amendments have been made to Ind AS 101. “First-time Adoption of Indian Accounting Standard”, Ind AS 103, “Business Combinations”, Ind AS 105 “Non-current Assets Held for Sale and Discontinued Operations”, Ind AS 107 “Financial Instruments: Disclosures”, Ind AS 109, “Financial Instruments” and Ind AS 115, “Revenue from Contracts with Customers” aligning them with newly introduced Ind AS 117.

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

RESERVE BANK OF INDIA (RBI)

Prudential Treatment of Bad and Doubtful Debt Reserve by Co-operative Banks

RBI has issued a notification dated 16 August 2024, on Prudential Treatment of Bad and Doubtful Debt Reserve (BDDR) by Co-operative Banks, prescribing the following revised instructions with a view to bring uniformity in the treatment of BDDR:

- With effect from FY 24-25, all provisions under Income Recognition, Asset Classification and Provisioning (IRACP) norms, whether accounted for under the head “BDDR” or any other head of account, shall be charged as an expense to the P&L account in the accounting period in which they are recognised. These provisions will still be eligible for regulatory capital purposes as per the existing capital adequacy guidelines.
- After charging all the applicable provisions as per IRACP norms and other extant regulations have been charged to the P&L Account, banks may make any appropriations of net profits below the line to BDDR, if required as per the applicable statutes or otherwise.
- To facilitate rectification and a smoother transition to an AS-compliant approach, the following regulatory treatment is prescribed:
  - Previously, banks may have created provisions required as per IRACP norms by appropriating from the net profit instead of recognising the same as an expense in the P&L account. The balances in BDDR as of 31 March 2024 which represents such provisions made by directly appropriating from net profits instead of recognising as an expense in the P&L Account in the previous years (hereafter referred to as ‘BDDR2024’) shall be identified and quantified.
  - As of 31 March 2025, to the extent of BDDR2024, an appropriation shall be made directly from the P&L Account or General Reserves to provisions for NPA which will be classified as a liability. These provisions shall be permitted to be netted off from GNPAs to arrive at NNPAs.
  - To the extent of balances in BDDR that are not required as per applicable statute can also be transferred to General Reserves or shown as Balance in P&L Account below the line.
  - After passing the above entries, the remaining balances in the BDDR can be reckoned as Tier 1 capital. However, this balance in the BDDR shall not be reduced from Gross NPAs to arrive at Net NPAs.
  - Banks must comply with the respective State Co-operative Societies Acts / Multi-State Co-operative Societies Act, 2002 as applicable.

This circular is applicable to all Primary (Urban) Co-operative Banks, State Co-operative Banks and Central Co-operative Banks. The instructions are applicable with immediate effect.

Review of Master Direction - Non-Banking Financial Company - Peer-to-Peer Lending Platform (Reserve Bank) Directions, 2017

RBI has issued a circular dated 16 August 2024, on Review of Master Direction - Non-Banking Financial Company – Peer to Peer Lending Platform (Reserve Bank) Directions, 2017. The notification addresses issues such as violations of the funds transfer mechanism, promoting peer-to-peer lending as an investment product with features like tenure-linked assured minimum returns, providing liquidity options and at times acting like deposit takers and lenders instead of being a platform. Accordingly, clarifications and modifications have been made to ensure proper implementation, and the relevant Master Direction has been updated accordingly. Following are certain key amendments:

- **No Credit Enhancements and Cross-Selling -** An NBFC-P2P shall not provide or arrange any credit enhancement or credit guarantee. NBFC-P2P shall not assume any credit risk, either directly or indirectly, arising out of transactions carried out on its platform. In other words, entire loss of principal or interest or both, if any, in respect of funds lent by lenders to borrowers on the platform shall be borne by the lenders and adequate disclosures to this effect shall be made to lenders as part of fair practices code. An NBFC-P2P shall not cross-sell any product except for loan-specific insurance products. It may be noted that NBFC-P2P shall not cross-sell any insurance product also which is in the nature of credit enhancement or credit guarantee.
- **No sale of insurance products -** An NBFC-P2P shall not cross-sell any product except for loan-specific insurance products. It may be noted that NBFC-P2P shall not cross-sell any insurance product also which is in the nature of credit enhancement or credit guarantee.
- **Cap on lender’s exposure -** The aggregate exposure of a lender to all borrowers at any point of time, across all P2P platforms, shall be subject to a cap of INR 50,00,000 provided that the amount lent by the lenders on P2P platforms is consistent with their net-worth.
- **Pricing policies -** NBFC-P2P platforms are now mandated to adopt a clear and objective approach and must ensure that fees are disclosed at the time of lending. Importantly, fees must remain fixed and not be affected by the borrower’s ability to repay. Additionally, the Guidelines restrict NBFC-P2P platforms from sourcing borrowers and lenders through affiliates or closed user groups, thereby emphasising transparency and fairness.
- **Compliance with Board-approved policy -** NBFC-P2P shall have a Board-approved policy in place - Setting out the rules for matching mapping lenders with borrowers in an equitable and non-discriminatory manner. Further, no loan shall be disbursed unless the lenders and the borrowers have been matched/ mapped as per the board-approved policy framed in terms of paragraph 8(1)(iii), the individual lender(s) have approved the individual recipient(s) of the loan and all concerned participants have signed the loan contract.

- **Fund Transfer Mechanism -** Fund transfer between the participants on the Peer to Peer Lending Platform shall be through escrow account mechanisms which will be operated by a bank-promoted trustee. At least two escrow accounts, one for funds received from lenders and pending disbursal (i.e., Lenders' escrow Account), and the other for collections from borrowers (i.e., Borrowers' escrow Account), shall be maintained. Under this prescribed funds transfer mechanism, funds from the lenders' bank accounts shall only be transferred to the Lenders' Escrow Account and shall only be disbursed to the specific borrower's bank account after ensuring compliance to paragraph 8(3) of these Directions.
- **Declaration from Investor -** NBFC-P2P shall be required to obtain an explicit declaration from the lender stating that he/she has understood all the risks associated with the lending transactions and that the P2P platform does not assure return of principal/payment of interest.
- **Restriction on outsourcing -** NBFC-P2Ps which choose to outsource any of their functions shall, however, not outsource core management functions including Internal Audit, Strategic and Compliance functions, pricing of services/ fees to be charged to borrowers/ lenders and decision-making functions such as determining compliance with KYC norms.
- **Disclosure Requirements -**

SECTION REFERENCE	MAXIMUM SCORE
▪ Details about the borrower(s) including personal identity with his/ her consent (which should be kept on record) ▪ Required amount ▪ Interest rate sought and ▪ Credit score as arrived by the NBFC-P2P	▪ Portfolio performance including share of NPAs on a monthly basis and segregation by age ▪ All losses are borne by the lenders on principal, interest or both

These are applicable to all non-banking financial companies – Peer-to-Peer Lending Platforms and shall come into effect immediately except the requirement of timeline (T+1) for transferring funds from the escrow accounts (both lender and borrower) shall come into effect ninety days from the circular.

INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY (IRDAI)

Prevention of Money-Laundering (Maintenance of Records) Amendment Rules, 2024

IRDAI vide circular dated 12 August 2024, amends the Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (PML Rules). As per the amendment, where additional or updated KYC information is obtained from a client under Rule 9(1C) of PML Rules, Insurers shall furnish the updated information to the Central KYC Registry (the CKYCR) as per Rule 9(1D). If an update in the KYC record of an existing client is informed by the CKYCR, the Insurers shall retrieve the updated KYC records from the CKYCR and update the KYC record maintained by it.

Insurers shall take note of the amendments to the PML Rules and take necessary steps to implement the same.

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Amendment To Master Circular For Infrastructure Investment Trusts (InvITs) - Board Nomination Rights To Unitholders Of InvITs

SEBI has issued a circular dated 6 August 2024, to provide clarification on the availability of the right to a unitholder to nominate a director on the Board of Directors of the Investment Manager of InvIT, where such nomination right is also available to a unitholder in the capacity of lender to the Investment Manager or the InvIT (or its HoldCos or SPVs).

Accordingly, to promote ease of doing business and based on the requests from the industry and recommendation of Hybrid Securities Advisory Committee (HySAC), the following proviso is proposed to be inserted in Master Circular for Infrastructure Investment Trusts dated 15 May 2024, clarifying that the restriction relating to the right to nominate a Unitholder Nominee Director shall not be applicable if the right to appoint a nominee director is available as per SEBI (Debenture Trustees) Regulations, 1993.

This circular shall come into force with immediate effect.

These circular impacts all InvITs, all parties to InvITs, all recognised stock exchanges and all depositories.

Amendment to Master Circular for Real Estate Investment Trusts (REITs) - Board Nomination Rights to Unitholders of REITs

SEBI has issued a circular dated 6 August 2024 to provide clarification on the availability of the right to nominate a director on the Board of Directors of the Manager of REIT, to a unitholder where such nomination right is also available to a unitholder in the capacity of lender to the Manager or the REIT(or its HoldCos or SPVs).

Accordingly, to promote ease of doing business and based on the request of the industry and recommendation of the Hybrid Securities Advisory Committee (HySAC), it is proposed to insert the proviso to clarify that restriction relating to the right to nominate a Unitholder Nominee Director shall not be applicable if the right to appoint a nominee director is available as per SEBI (Debenture Trustees) Regulations,1993.

This circular shall come into force with immediate effect.

This circular impacts all REITs, all Parties to REITs, all Recognised Stock Exchanges and all Depositories.

Securities and Exchange Board of India (Mutual Funds) (Second Amendment) Regulations, 2024

SEBI vide notification dated 1 August 2024, has issued further amendments to the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996. The following are key amendments:

- **Definition of Market Abuse -** New clause was inserted to define “market abuse” which includes manipulative, fraudulent and unfair trade practices which may contravene Section 12A of the Act or any of the provisions of the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 or the Securities and Exchange Board of India (Prohibition of Insider Trading) Regulations, 2015.
- **Institutional Mechanism -** The asset management company shall put in place an institutional mechanism, as may be specified by the Board, for the identification and deterrence of potential market abuse including front-running and fraudulent transactions in securities. The Chief Executive Officer or Managing Director or such other person of equivalent or analogous rank and Chief Compliance Officer of the asset management company shall be responsible and accountable for the implementation of such an institutional mechanism for deterrence of potential market abuse, including front-running and fraudulent transactions in securities.
- **Whistle-Blower Policy -** The asset management company shall establish, implement and maintain a documented whistle-blower policy that shall provide a confidential channel for employees, directors, trustees, and other stakeholders to raise concerns about suspected fraudulent, unfair or unethical practices, violations of regulatory or legal requirements or governance vulnerability, and establish procedures to ensure adequate protection of the whistle-blowers.

Securities and Exchange Board of India (Alternative Investment Funds) (Fourth Amendment) Regulations, 2024

SEBI vide notification dated 5 August 2024, has issued further amendments to the Securities and Exchange Board of India (Alternative Investment Funds) Regulations, 2012. The following are key amendments:

- The proviso to regulation 13(5), shall be substituted and as per amendment a large value fund for accredited investors may be permitted to extend its tenure up to five years in place of 2 years, subject to the approval of two-thirds of the unit holders by value of their investment in the large value fund for accredited investors and shall be subject to such conditions as may be specified by the Board from time to time.
- Regulation 16 (1)(c) and 17(c) has been amended to specify that Category I Alternative Investment Funds shall not borrow funds or engage in any leverage for the purpose of making investments or otherwise. Earlier, the purpose was not specified in the provision.

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

Modalities for migration of Venture Capital Funds registered under erstwhile SEBI (Venture Capital Funds) Regulations, 1996 to SEBI (Alternative Investment Funds) Regulations, 2012

SEBI has issued a circular dated 19 August 2024, on Modalities for migration of Venture Capital Funds (VCFs) registered under erstwhile SEBI (Venture Capital Funds) Regulations, 1996 (VCF Regulations) to SEBI (Alternative Investment Funds) Regulations, 2012 (AIF Regulations).

Migrated VCF means a fund that was previously registered as a Venture Capital Fund under the VCF Regulations and subsequently registered under AIF Regulations as a sub-category of Venture Capital Fund under Category I - Alternative Investment Fund.

The circular provides the following guidelines for VCFs to migrate to AIF Regulations, including conditions for unliquidated investments and scheme tenures.

- VCFs must apply for migration by 19 July 2025 or face regulatory actions if non-compliant.
- Application for registration as a Migrated VCF shall be made to SEBI in the manner specified by SEBI and while applying, VCFs shall submit the following:
  - Original certificate of registration issued under VCF Regulations.
  - Requisite information as per the format specified in Annexure I.
- While opting for migration, VCFs having only schemes whose liquidation period has not expired, shall be subject to the following conditions:
  - The facility of migration to AIF Regulations shall be available till 19 July 2025.
  - The tenure of scheme(s) for Migrated VCF, upon migration, shall be determined in the following manner:
    - In case a definite tenure was disclosed in the Private Placement Memorandum (PPM) of the scheme(s) under the VCF Regulations, such scheme(s) shall continue with the same tenure upon migration.
    - In case a definite tenure was not disclosed in the PPM of the scheme(s), the residual tenure of the scheme(s) of the Migrated VCF shall be determined prior to the application for migration, with the approval of 75 % of investors by the value of their investment in the scheme(s).
- While opting for migration, VCFs having at least 1 scheme which has not been wound up post-expiry of its liquidation period, shall be subject to the following conditions:
  - Such VCFs may apply for registration as Migrated VCF on or before 19 July 2025, only if the VCF or any of its scheme(s) do not have any pending investor complaint with regard to non-receipt of funds/ securities as of the date of the application.
  - A one-time additional liquidation period of 1 year from the date of notification of amendment to AIF Regulation which is the period till 19 July 2025 shall be available to scheme of the migrated VCF, whose liquidation period has expired and is not wound up.
  - If the VCF also has other scheme(s), the tenure of such schemes of the Migrated VCF shall be determined as per the provision above upon migration.
- Upon migration, the investors on-boarded, investments held and units issued by the VCF or schemes of the VCF registered under VCF Regulations, shall be deemed to be that of the Migrated VCF or its schemes, under the AIF Regulations.
- With respect to VCFs registered under VCF Regulations that do not opt for migration to AIF Regulations, the following is specified:
  - VCFs schemes, whose liquidation period has not expired, shall be subject to enhanced regulatory reporting as may be prescribed by SEBI in line with the regulatory reporting applicable to AIFs under AIF Regulations.
  - VCFs having at least one scheme whose liquidation period has expired shall be subject to appropriate regulatory action for continuing beyond the expiry of their original liquidation period.
- The flexibility to opt for migration to AIF Regulations shall not be available to VCFs wherein:
  - All the schemes of the VCF have been wound up; and/or,
  - No investment has been made by schemes of the VCF which have not been wound up.

  Such VCFs shall submit an application to SEBI for surrender of their registration on or before 31 March 2025, failing which appropriate action shall be initiated to cancel the certification of registration.

This circular shall come to force with immediate effect.

This circular impacts all AIFs and VCFs registered under the erstwhile SEBI (Venture Capital Funds) Regulations, 1996.

Amendment to Master Circular for Real Estate Investment Trusts (REITs) dated 15 May 2024 - Review of statement of investor complaints and timeline for disclosure of statement of deviation(s)

SEBI vide circular dated 22 August 2024, issued amendments to the Master Circular for Real Estate Investment Trusts (REITs) dated 15 May 2024, with regard to review of statement of investor complaints and the timeline for disclosure of statement of deviations.

Prior to the amendment, the Board of Directors (BOD) of the Manager of REITs were required to review investor complaints before submitting the statement to the stock exchanges. This amendment aligns this process with SEBI Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, promoting ease of doing business. Hence, as per the amendment, the statement of investor complaints is required to be reviewed quarterly by both the trustee and the BOD/Governing Body of the Manager, eliminating the need for prior review before submission.

Furthermore, SEBI has updated the timeline for submitting statements on deviations from the intended use of proceeds. Prior to the amendment, these statements had to be submitted within 21 days after the end of each quarter. The amendment now requires that these statements be submitted to the stock exchanges on a quarterly basis along with the financial results, thereby reducing redundancy and making the process more efficient.

This circular shall be come into force with immediate effect.

This circular impacts all REITs, parties to REITs and all Recognised Stock Exchanges.

Amendment To Master Circular For Infrastructure Investment Trusts (InvITs) Dated 15 May 2024 - Review Of Statement Of Investor Complaints And Timeline For Disclosure Of Statement Of Deviation(s)

SEBI vide circular dated 22 August 2024, issued amendments to Master Circular for Infrastructure Investment Trusts (InvITs) dated 15 May 2024, with regard to review of statement of investor complaints and timeline for disclosure of statement of deviations.

Prior to the amendment, the Board of Directors (BOD) of the Investment Manager of InVITs were required to review investor complaints before submitting the statement to the stock exchanges. This amendment aligns this process with SEBI Listing Obligations and Disclosure Requirements (LODR) Regulations, 2015, promoting ease of doing business. Hence, as per the amendment, the statement of investor complaints is required to be reviewed quarterly by both the trustee and the BOD/Governing Body of the Investment Manager, eliminating the need for prior review before submission.

Furthermore, SEBI has updated the timeline for submitting statements on deviations from the intended use of proceeds. Prior to the amendment, these statements had to be submitted within 21 days after the end of each quarter. The amendment now requires that these statements be submitted to the stock exchanges on a quarterly basis along with the financial results, thereby reducing redundancy and making the process more efficient.

This circular shall be applicable with immediate effect.

This circular impacts all InvITs, parties to InvITs and all Recognised Stock Exchanges.

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

SEBI vide notification dated 26 August 2024, has issued amendments to the Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018, with insertion of chapter VIA with regard to 'Restriction recognised stock exchanges and clearing corporations in dealing with unregulated/other entities'.

As per the amendment, no recognised stock exchange or recognised clearing corporation or their agent, shall have any direct or indirect association with another person who provides advice or any recommendation, directly or indirectly, in respect of or related to a security or securities, unless the person is registered with or otherwise permitted by the Board to provide such advice or recommendation; or makes any claim, of returns or performance expressly or impliedly, in respect of or related to a security or securities, unless the person has been permitted by the Board to make such a claim. However, it has been clarified that these provisions shall not apply in respect of an association through a specified digital platform.

Further, the recognised stock exchange or recognised clearing corporation shall ensure that any person associated with them, or their agent does not engage in the activities mentioned above without the necessary permission.

Explanations 1, 2, and 3 are also mentioned which provide the meaning of 'association', 'specified digital platform', and 'another person' respectively.

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

Securities and Exchange Board of India (Depositories and Participants) (Second Amendment) Regulations, 2024

SEBI vide notification dated 26 August 2024, has issued amendments to the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 with regard to 'Restriction on depositories and their agents in dealing with other entities'.

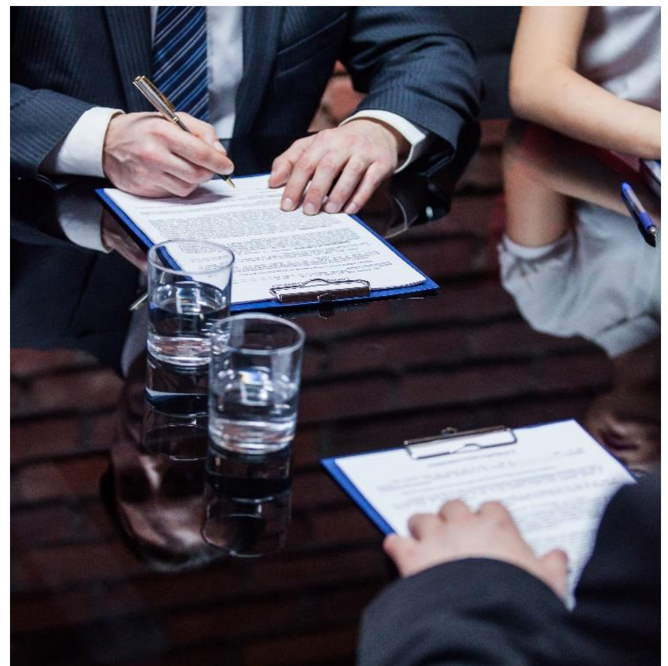
As per the amendment, no depository or its agent shall have any direct or indirect association with another person who provides advice or any recommendation, directly or indirectly, in respect of or related to a security or securities, unless the person is registered with or otherwise permitted by the Board to provide such advice or recommendation; or makes any claim, of returns or performance expressly or impliedly, in respect of or related to a security or securities, unless the person has been permitted by the Board to make such a claim. However, it has been clarified that these provisions shall not apply in respect of an association through a specified digital platform.

Further, the depository shall ensure that any person associated with it, or its agent does not engage in the activities mentioned above without the necessary permission.

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

Explanations 1, 2, and 3 are also mentioned which provide the meaning of 'association', 'specified digital platform', and 'another person' respectively.

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



Securities and Exchange Board of India (Intermediaries) (Amendment) Regulations, 2024

SEBI vide notification dated 26 August 2024, has issued amendments to the Securities and Exchange Board of India (Depositories and Participants) Regulations, 2018 with regard to ‘Restriction on persons regulated by the Board and their agents in having association with certain persons’.

As per the amendment, no person regulated by the Board or the agent of such a person shall have any direct or indirect association, with another person who provides advice or any recommendation, directly or indirectly, in respect of or related to a security or securities, unless the person is registered with or otherwise permitted by the Board to provide such advice or recommendation; or makes any claim, of returns or performance expressly or impliedly, in respect of or related to a security or securities, unless the person has been permitted by the Board to make such a claim. However, it has been clarified that these provisions shall not apply in respect of an association through a specified digital platform.

Further, the person regulated by the Board shall ensure that any person associated with it, or its agent does not engage in the activities mentioned above without the necessary permission.

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

REGULATORY UPDATES

REGULATORY UPDATES:

SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI)

Circular Dated 1 August 2024: Amendment To Circular For Mandating Additional Disclosures By Foreign Portfolio Investors (FPIs) That Fulfil Certain Objective Criteria

SEBI vide circular dated 24 August 2023, mandated additional disclosures for FPIs meeting specific criteria. Further, FPIs satisfying any of the criteria listed under Para 8 of the said circular were exempted from the additional disclosure requirements, subject to conditions specified in the said circular. This circular was later included in the FPI Master Circular dated 30 May 2024.

The FPI Master Circular has been updated to exempt University Funds and University-related Endowments from the additional disclosure requirements specified in Para 1(xiii) of Part C, provided they meet certain conditions. In view of the above, the FPI Master Circular stands modified as follows:

After clause (g) of Para 1(xiv) of Part C, the following shall be inserted:

"(h) University Funds and University-related Endowments, registered or eligible to be registered as Category I FPI, subject to them fulfilling the following additional conditions:

- Indian equity AUM being less than 25% of global AUM
- Global AUM being more than INR 10,000 crore equivalent
- Appropriate return/filing to the respective tax authorities in their home jurisdiction to evidence the nature of a non-profit organisation exempt from tax."
- The provisions of this circular shall come into force with immediate effect.

Circular Dated 5 August 2024: Institutional Mechanism By Asset Management Companies (AMCs) For Identification And Deterrence Of Potential Market Abuse Including Front-running And Fraudulent Transactions In Securities

SEBI has issued a circular on Institutional mechanisms by AMCs for identification and deterrence of potential market abuse including front-running and fraudulent transactions in securities, dated 5 August 2024. This mechanism shall consist of enhanced surveillance systems, internal control procedures, and escalation processes such that the overall mechanism is able to identify, monitor and address specific types of misconduct, including front-running, insider trading, misuse of sensitive information, etc.

The mechanism shall ensure the following-

Accountability, an alert-based surveillance mechanism, processing of alerts, standard operating procedures, action on suspicious alerts, escalation process, whistleblower policy, periodic review, trade-related information from exchanges, and reporting to SEBI.

The Association of Mutual Funds in India (AMFI), in consultation with SEBI, will issue detailed implementation standards within 15 days to ensure consistent application across the industry.

Circular Dated 5 August 2024: Valuation Of Additional Tier 1 Bonds (AT-1 Bonds)

SEBI, through its circular dated 5 August 2024, has mandated that the valuation of Additional Tier 1 Bonds (AT-1 Bonds) by Mutual Funds shall be based on the Yield to Call (YTC) method.

National Financial Reporting Authority (NFRA), in its report to the Department of Economic Affairs, Ministry of Finance, has recommended this approach, noting that market practice for AT-1 Bonds typically reflects prices close to YTC. Valuing AT-1 Bonds using YTC, adjusted for appropriate risk spreads, aligns with the principles of market-based measurement under Ind AS 113. This recommendation is specifically for how to value these bonds under Ind AS 113 and does not affect other uses or the concept of maturity for these bonds.

In response, Mutual Funds will now value AT-1 Bonds using the YTC method. However, for other purposes, such as assessing liquidity risk, the existing rules about the deemed maturity of perpetual bonds will still apply.

For all other purposes, since the liquidity risk of perpetual bonds is required to be suitably captured, the deemed maturity of all perpetual bonds shall continue to follow the guidelines in the Master Circular dated 27 June 2024.

Circular Dated 9 August 2024: Master Circular For Stockbrokers

The Securities and Exchange Board of India (SEBI) released a Master Circular on 22 May 2024, for stockbrokers, providing a comprehensive overview of applicable circulars in one document.

On 9 August 2024, SEBI issued an updated Master Circular, which consolidates all relevant guidelines and directions for stockbrokers up to that date, superseding the previous circular from 22 May 2024. This updated circular also rescinds certain provisions from earlier circulars. However, any actions, pending applications, and liabilities under the previous circulars remain valid and are carried over to the new Master Circular.

The list of changes incorporated in the circular is as below:

- Provisions of circular on ‘Enhancement of operational efficiency and Risk reduction – Pay-out of securities directly to client demat account’ dated 5 June 2024;
- Provisions of circular on ‘Measures to instil confidence in securities market – Brokers’ institutional mechanism for prevention and detection of fraud or market abuse’ dated 4 July 2024;
- Option has been given to brokers to send contract notes either in physical mode or through electronic instant messaging services in case ECN has not been delivered to the client or has been rejected by the email id of the client;
- Provisions of circular on ‘Modification to Enhanced Supervision of Stockbrokers and Depository Participants’ dated 4 July 2024;
- Provisions related to conciliation proceedings have been incorporated.

Circular Dated 19 August 2024: Guidelines For Borrowing By Category I And Category II Alternative Investment Funds (AIFs) And Maximum Permissible Limit For Extension Of Tenure By Large Value Fund For Accredited Investors (LVFs)

SEBI issued a circular on 19 August 2024, detailing new guidelines for Category I and Category II AIFs regarding borrowing and tenure extension for LVFs.

- **Guidelines for borrowing by Category I and Category II AIFs**

Under the updated regulations, these AIFs are restricted from borrowing funds for investments, except to address short-term funding gaps. Such borrowing must not exceed 20% of the intended investment or 10% of the investable funds and must only occur in emergencies. AIFs must wait 30 days between two borrowing periods, calculated from the repayment date of the previous borrowing. The cost of borrowing is to be borne by the investors who fail to provide the necessary drawdown amount, and the process cannot be used to offer different drawdown timelines.

- **Maximum permissible limit for extension of tenure by LVFs**

Additionally, SEBI has revised the maximum tenure extension for LVFs to five years, with the consent of two-thirds of unit holders by value. Existing LVF schemes must align with these new rules by 18 November 2024. The 30-day cooling-off period between borrowings requires comprehensive disclosure to all investors regarding borrowed amounts.

This circular shall come into force with immediate effect.

Circular Dated 20 August 2024: Circular Relating To Cybersecurity And Cyber Resilience Framework (CSCRF) For SEBI Regulated Entities (REs)

SEBI has issued a circular on CSCRF for REs, dated 20 August 2024. The CSCRF establishes standards and guidelines to strengthen cybersecurity and resilience against cyber incidents across various REs. The framework introduces a graded approach, mandatory Security Operations Centres (SOCs), and a Cyber Capability Index (CCI) for monitoring progress.

The framework categorises entities based on their size and scope and includes a structured methodology for implementation and compliance. It mandates the establishment of SOC and provides provisions for both self-managed and market-provided SOCs, aiming to simplify compliance for smaller entities.

Implementation period –

- For six categories of REs where cybersecurity and cyber resilience circular already exists - by 1 January 2025.
- For other REs where CSCRF is being issued for the first time - by 1 April 2025.

REs shall put in place appropriate systems and procedures to ensure compliance with the provisions (i.e., applicable standards and guidelines) of CSCRF, and conduct a cyber audit as per CSCRF after the above-mentioned timelines. Cyber audit reports along with other required documents shall be submitted as per timelines provided in the CSCRF.

Notification Dated 19 August 2024: Fees Charged By Research Analysts

SEBI established a working group to review and improve the SEBI issued a circular amending the Securities and Exchange Board of India (Research Analysts) Regulations 2014. The updated regulations will take effect from the date of their publication in the official gazette.

The amendment introduces a new clause that outlines the entitlement of fees for Research Analysts stating that Research Analyst shall be entitled to charge fees for providing research services from a client, including an accredited investor, in the manner as specified by the Board.

Circular Dated 30 August 2024: Review Of Eligibility Criteria For Entry/ Exit Of Stocks In The Derivatives Segment

SEBI issued a Master Circular on Stock Exchanges and Clearing Corporations dated 16 October 2023 which lays down the eligibility criteria for entry/exit of stocks in the derivatives segment.

SEBI vide circular dated 30 August 2024, has amended the entry norms and exit norms based on performance in the underlying cash market. Further, it has also introduced exit norms based on the introduction of a Product Success Framework (PSF) for stock derivatives.

Entry Norms for stocks in the derivatives segment

Stocks that meet the specified eligibility criteria, based on their performance in the underlying cash market, over a continuous period of six months (evaluated on a rolling basis using data from the previous six months), will qualify for inclusion in the derivatives segment.

Key changes include-

- Increasing the Market Wide Position Limit (MWPL) from INR 500 crores to INR 1,500 crores;
- Raising the Median Quarter Sigma Order Size (MQSOS) from INR 25 lakhs to INR 75 lakhs; and
- Stock’s Average Daily Delivery Values (ADDV) in the cash market, in the previous six months on a rolling basis, shall not be less than INR 35 crores which was earlier INR 10 crores.

Exit norms based on performance in the underlying cash market

- If a stock in the derivatives segment fails to meet the criteria for three consecutive months (on a rolling basis), it will exit the segment.
- Existing contracts can still be traded until expiry and new strikes may be introduced.
- Stocks must have been in the segment for at least six months to be subject to these exit criteria.
- Additionally, there's a three-month gestation period for existing stocks before the exit criteria apply. Stocks will exit if they fail to meet criteria across all exchanges but can remain if they meet criteria on any exchange. Once excluded, a stock cannot be reintroduced for one year.

Exit norms based on the introduction of a Product Success Framework (PSF) for stock derivatives

Additional exit criteria for single stock derivatives include:

- At least 15% of trading members (or 200 members) must trade the stock monthly.
- The stock must be traded on at least 75% of trading days.
- Average daily turnover (futures + options premium) must be at least INR 75 crores.
- Average daily notional open interest (futures + options notional) must be at least INR 500 crores.

Stocks failing any of these criteria for three consecutive months will see no new contracts issued, though existing contracts can continue until expiry. Stocks must have been in the derivatives segment for at least six months before review.

Stock exchanges are required to update their regulations and systems accordingly and communicate implementation status to SEBI.

RESERVE BANK OF INDIA (RBI)

Notification Dated 6 August 2024: Modified Interest Subvention Scheme (MISS) For Short Term Loans For Agriculture And Allied Activities Availed Through Kisan Credit Card (KCC) During The Financial Year 2024-25

RBI has extended the Modified Interest Subvention Scheme for short-term agricultural loans through Kisan Credit Cards (KCC) for the financial year 2024-25.

This scheme offers interest subvention on loans up to INR 3 lakh for crop and related activities, including animal husbandry and dairy. It features a base interest rate of 7%, with a subvention of 1.5%. For timely repayments, an additional 3% subvention is available, bringing the effective interest rate down to 4%. Additionally, the scheme supports small farmers by covering the costs of storing produce in accredited warehouses for up to six months after harvest.

To assist farmers affected by natural disasters, banks will receive an interest subvention on restructured loans for the first year. From the second year onward, the normal interest rate will apply. For farmers impacted by severe calamities, the interest subvention will be provided for up to three years or the entire loan period, whichever is shorter (up to five years).

Additionally, affected farmers will be eligible for a 3% annual prompt repayment incentive. The decision to grant these benefits will be made by a High-Level Committee (HLC), based on recommendations from the Inter-Ministerial Central Team (IMCT) and the Sub-Committee of the National Executive Committee (SC-NEC).

Aadhar linkage is mandatory for availing of these benefits. Banks are required to report detailed data on the Kisan Rin Portal and ensure claims are certified by statutory auditors by 30 June 2025.

Notification Dated 8 August 2024: Frequency Of Reporting Of Credit Information By Credit Institutions (CIs) To Credit Information Companies (CICs)

RBI has issued a directive requiring CIs and CICs to update and report credit information on a fortnightly basis, effective 1 January 2025.

This update, replacing the previous monthly reporting cycle, aims to ensure more current and accurate Credit Information Reports (CIRs) that reflect borrowers' latest credit activities. CIs must submit credit data by the 15th and last day of each month, with CICs required to process and ingest this data within five days of receipt. These instructions will become effective from 1 January 2025, though CIs and CICs are encouraged to implement them as soon as possible before this date.

Non-compliance will result in penalties under the Credit Information Companies (Regulation) Act, 2005.

Additionally, CICs are instructed to provide a list of non-compliant CIs to the RBI for monitoring purposes on a half-yearly basis. The RBI encourages CIs and CICs to implement these measures as soon as possible but no later than the stipulated deadline.

Notification Dated 12 August 2024: Review Of Regulatory Framework For All Housing Finance Companies (HFCs) And Harmonisation Of Regulations Applicable To HFCs And All Non-banking Finance Companies (NBFCs)

RBI has issued a notification on the review of regulatory framework for HFCs and harmonisation of regulations applicable to HFCs and NBFCs, dated 12 August 2024. This follows the transfer of HFC regulation from NHB to RBI, aiming to harmonise the regulations applicable to both HFCs and NBFCs. The revised regulations will be effective from 1 January 2025, with specific updates detailed in the Annexure.

Part A - Section I of the Annexure provides guidelines regarding the Acceptance of Public Deposits, applicable only to HFCs holding Certificate of Registration (CoR) to accept/ hold public deposits. Section II provides other instructions applicable to HFCs.

Part B – Section III of the Annexure provides guidelines regarding the Acceptance of Public Deposits, applicable only to NBFCs holding CoR to accept/ hold public deposits. Section IV provides other instructions applicable to NBFCs.

Circular Dated 12 August 2024: Review Of Risk Weights For Housing Finance Companies (HFCs)

RBI has updated the risk weight guidelines for HFCs as per its circular dated 12 August 2024. The modification addresses two main areas:

- **Risk-weighted assets for undisbursed amounts of housing loans/other loans –**

In order to address a potential anomaly in the computation of risk-weighted assets for undisbursed amount of housing loans/other loans vis-à-vis that for an equivalent disbursed amount of similar exposures, it has been decided that the risk-weighted assets computed for undisbursed amount of housing loans/other loans shall be capped at the risk-weighted asset computed on a notional basis for equivalent amount of disbursed loan.

- **Risk weight for Commercial Real Estate - Residential Building –**

The risk weight for fund-based and non-fund-based exposures to this category, provided they are classified as standard, will now be set at 75 per cent. This is a reduction from the previous levels and reflects a more favourable risk assessment for standard assets in this category.

These revised instructions are effective immediately from the date of issuance of this circular.

Notification Dated 22 August 2024: Processing Of e-Mandates For Recurring Transactions

The RBI has issued a notification regarding the processing of e-mandates for recurring transactions, effective 22 August 2024. The e-mandate framework prescribed, inter alia, that the issuer shall send a pre-debit notification to the customer at least 24 hours prior to the actual charge/ debit to the account.

This notification incorporates the auto-replenishment of balances for FASTag and National Common Mobility Card (NCMC) transactions within the e-mandate framework.

Additionally, it specifies that payments for auto-replenishment transactions, which are recurring but do not adhere to a fixed periodicity, will be exempt from the pre-debit notification requirement.

All other existing guidelines under the e-mandate framework remain unchanged.

Notification Dated 27 August 2024: Implementation Of Section 51A Of UAPA, 1967: Updates To UNSC's 1267/1989 ISIL (Da'esh) & Al-qaida Sanctions List: Amendments In 01 Entry

The Reserve Bank of India (RBI) has issued a notification dated 27 August 2024, addressed to all Chairpersons and Chief Executive Officers of Regulated Entities (REs). This notification updates them on changes to the United Nations Security Council (UNSC) sanctions list and reinforces the need for compliance with anti-terrorism regulations as outlined in Section 51A of the Unlawful Activities (Prevention) Act (UAPA), 1967.

Section 51A of the UAPA mandates that REs must not maintain accounts for individuals or entities identified by the UNSC as having links to terrorism. In this context, the UNSC Committee, through a press release dated 23 August 2024, has announced the removal of a specific individual from the ISIL (Da'esh) and Al-Qaida Sanctions List.

Res is therefore advised to review the recent UNSC updates carefully and ensure strict adherence to the regulations.

Notification Dated 31 August 2024: Interest Equalisation Scheme (IES) On Pre And Post-shipment Rupee Export Credit

RBI had issued instructions vide circular dated 22 February 2024, in relation to Interest Equalisation Scheme (IES) on Pre and Post-Shipment Rupee Export Credit. Following this, the Government of India released trade notices on 28 June 2024, and 10 July 2024, extending the IES until 31 August 2024.

Further, the government has advised the following modifications to the scheme:

- **Eligibility of borrowers:** With effect from 1 July 2024, only MSME Manufacturer exporters would be eligible under the Scheme. Hence, the Scheme benefits will not be available to non-MSME exporters, and such claims are not to be entertained beyond 30 June 2024.
- **Cap on subvention amount:** The interest equalisation will be capped at INR 1.66 Crore per Importer-Exporter Code (IEC) for the aforesaid extended period of the scheme.

Consequently, the RBI's previous instructions have been modified accordingly, while all other provisions of the existing instructions on the IES issued by the Bank remain unchanged.

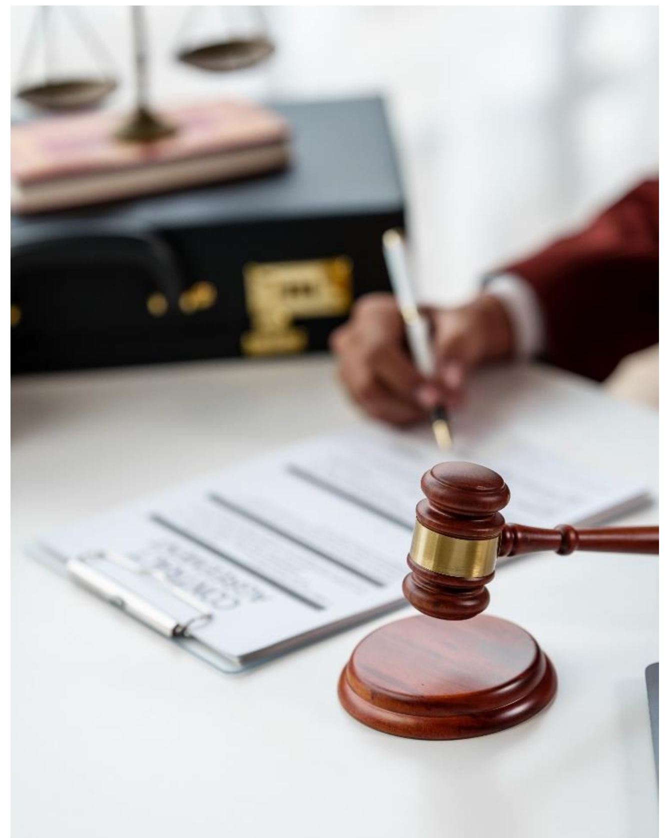
Notification Dated 29 August 2024: Scheme For Trading And Settlement Of Sovereign Green Bonds In The International Financial Services Centre In India

RBI has issued a notification dated 29 August 2024, introducing a new Scheme for Trading and Settlement of Sovereign Green Bonds (SGrBs) in the International Financial Services Centre in India which shall come into force with immediate effect.

This scheme allows eligible foreign investors to invest in SGrBs issued by the Indian government and also the notification calls out for amendments to existing e Foreign Exchange Management (Debt Instruments) Regulations, 2019.

The Scheme outlines the scope, eligible investors, participation procedures, and settlement processes within the IFSC. The scheme stipulates that only authorised entities like depositories and clearing corporations in the IFSC can manage the accounts and settlements. It also defines the roles of IFSC Banking Units (IBUs) and sets guidelines for Know Your Customer (KYC) and Anti-Money Laundering (AML) practices. The scheme requires strict data management and reporting protocols to ensure transparency and compliance. The scheme's terms also clarify taxation, trading procedures, and the applicability of other relevant Indian laws.

The operational guidelines for participation in the Scheme by entities in the IFSC shall be issued by the IFSC authority.



INSURANCE REGULATORY AND DEVELOPMENT AUTHORITY OF INDIA (IRDAI)

Circular Dated 8 August 2024: Submission Of Data By Life Insurers To The Insurance Information Bureau Of India (IIBI)

IRDAI has issued a directive to all life insurance companies, requiring them to submit data to IIBI for the period and in the formats specified in the table below by 30 September 2024.

SR NO	CATEGORY	PERIOD	FORMAT
1	Individual Life Insurance	2023-24	Annexure - I
2	Individual Annuitant Policies	2016-24	Annexure - II
3	Group Annuitant Policies	2016-24	Annexure - III
4	Critical Illness Products	2019-24	Annexure - IV
5	Group Credit Life	2020-24	Annexure - V
6	Group Term Insurance	2020-24	Annexure - VI
7	PMJJBY	2020-24	Annexure - VII

The insurers shall continue to submit the data at an annual frequency from FY2024-25 within a period of three months of completion of every Financial Year. This circular supersedes earlier circulars issued in November 2014, August 2019, and October 2019.

DIRECT TAX

CIRCULARS/ NOTIFICATIONS/ PRESS RELEASE

CBDT Grants Relaxation From The Applicability Of A High Tax Withholding Rate Where Pan-Aadhaar Linking Is Not Done Before 31 May 2024 And The Deductee/ Collectee Has Died

The Central Board of Direct Taxes (CBDT) had issued a circular[1] to extend the timeline for PAN-Aadhar linking to 31 May 2024 in respect of transactions entered up to 31 March 2024. Where the deductee/ collectee had passed away on or before 31 May 2024, i.e. before the option to link PAN and Aadhaar could have been exercised, tax demands are standing against the deductor or collector as a result of failure to link PAN and Aadhaar of the deceased person.

The CBDT has issued another circular[2] specifying that in respect of cases where a higher rate of TDS or TCS was attracted under section 206AA or 206CC of the Income Tax Act, 1961 (IT Act) pertaining to the transactions entered into up to 31 March 2024 and in case of demise of the deductee or collectee on or before 31 May 2024 i.e. before the linkage of PAN and Aadhaar could have been done, there shall be no liability on the deductor or collector to deduct or collect the tax under section 206AA or 206CC of the IT Act, as the case may be. The deduction or collection as mandated in other provisions of Chapter XVII-B or Chapter XVII-BB of the IT Act shall be applicable.

[Circular No 8 of 2024 dated 5 August 2024 and Press Release dated 7 August 2024]

Finance (No.2) Bill, 2024, As Amended, Receives President's Assent

The Finance (No. 2) Bill, 2024 (the Bill) was introduced by the Hon'ble Finance Minister in the Lok Sabha on 23 July 2024

Subsequently, on 6 August 2024, the amendments to the Bill have been tabled in the Lok Sabha by notice of amendments. The Bill so amended has been passed by Lok Sabha on 7 August 2024. The revised Finance Bill received the President's assent on 16 August 2024 and has been notified in the official gazette. To read our detailed analysis on the amendment made in the Bill, please go to https://www.bdo.in/en-gb/insights/alerts-updates/tax-alert-amendment-proposed-in-finance-no-2-bill-2024

CBDT Issues Clarification In Respect Of Income Tax Clearance Certificate

Section 230(1A) of the IT Act provides certain circumstances for obtaining an income tax clearance certificate (ITCC) by persons domiciled in India. The Finance (No. 2) Act, 2024 has amended section 230(1A) of the IT Act to bring the liabilities under the Black Money (Undisclosed Foreign Income and Assets) and Imposition of Tax Act, 2015 (the 'Black Money Act') within its ambit. This amendment was misinterpreted to mean that all Indian citizens must obtain ITCC before leaving the country.

CBDT has issued a press release in order to clarify the applicability that only certain taxpayers as mentioned below are required to obtain ITCC;

- Where a person is involved in serious financial irregularities or
- Here a tax demand of more than INR 1mn is pending which is not stayed by any authority.

The position laid by the statute since 2003 remains unchanged even with the amendments vide Finance (No. 2) Act, 2024.

[Press release dated 20 August 2024]

[1] Circular No. 6 of 2024 dated 23 April 2024
[2] Circular No. 8 of 2024

CBDT Notifies e-Dispute Resolution Scheme (e-DRS) 2022

Pursuant to section 245MA[3] of the IT Act, the CBDT had notified the e-Dispute Resolution Scheme, 2022 (e-DRS) with an aim to reduce litigation and provide relief to eligible taxpayers.

Taxpayer, who fulfils specified conditions as stipulated in section 245MA of the IT Act, may file an application electronically for dispute resolution to the Dispute Resolution Committee (DRC) designated for the region of Principal Chief Commissioner of Income-tax (PCCIT) having jurisdiction over the taxpayer. In order to facilitate the scheme, DRCs have been constituted in all 18 jurisdictional PCCIT regions across the country.

Under e-DRS, the DRC is mandated to pass its order within six months from the end of the month in which the application for dispute resolution is admitted by it. The application for e-DRS is to be filed in Form No. 34BC on the e-filing portal of the Income Tax Department:

- Within one month from the date of receipt of specified order;
- On or before 30 September 2024, in the cases where -
  - Appeal has already been filed and is pending before the First Appellate Authority [CIT(Appeals)];
  - The specified order has been passed on or before 31 August 2024 and the time for filing an appeal against such order before CIT (Appeals) has not lapsed.

The taxpayer can access the e-DRS module by logging on income tax portal https://eportal.incometax.gov.in

[Press Release dated 30 August 2024]

JUDICIAL UPDATES

Madras HC Holds That Compensation Paid For Diminution In The Value Of ESOP Is A Prerequisite

The taxpayer is an employee of Flipkart Internet Private Limited (FIPL) which is a step-down subsidiary of Flipkart Private Limited, Singapore (FPS). In the year 2012, FPS rolled out a Flipkart Stock Option Plan (FSOP) wherein, FPS granted certain Employee Stock Option Plans (ESOPs) to either employees or any other persons approved by the Board and to whom stock options were granted. Owing to the disinvestment of FPS in its wholly owned subsidiary, PhonePe, the value of the stock options of FPS fell. In order to compensate the option holders for the loss in the value of options, on 21 April 2023, FPS granted the option holders a one-time payment of USD 43.67 per option based on the number of options held on 23 December 2022.

As of 23 December 2022, out of the above-mentioned ESOPs, 2137 had vested in the taxpayer as per the terms of the FSOP 2012 and 3787 had not vested, thereby aggregating to 5924 ESOPs of FPS under the FSOP 2012. The taxpayer had not exercised the option in respect of the vested ESOPs. The compensation was paid to the taxpayer by withholding tax under Section 192 of the IT Act. The taxpayer filed an application for a 'nil' tax withholding certificate under Section 197 of the IT Act with the tax officer on the ground that the amount received as compensation was a capital receipt which is not liable to income tax. The application was rejected by the tax authorities.

Aggrieved, the taxpayer filed a writ petition before the Hon'ble Madras High Court. The Hon'ble Madras HC, while upholding the tax officer's order, declined to follow Delhi HC's ruling in the case of Sanjay Baweja[4]. While coming to this conclusion, it made the following observations:

- As per section 2(14) of the IT Act, in order to qualify as a capital asset, it should be property of any kind held by the taxpayer, including, as per the legal fiction in Explanation 1, rights in or in relation to an Indian company, such as rights of management or control. Shares are indisputably capital assets because they qualify as movable goods under the Sale of Goods Act, 1930 and the Companies Act, 2013 (CA 2013) and, consequently, fall within the scope of the expression "any property" in Section 2(14) of the IT Act.
- ESOPs, by contrast, are rights in relation to capital assets, i.e. rights to receive capital assets (shares) subject to the terms and conditions of the ESOP scheme. Since the taxpayer has no rights in the Indian company of which he is an employee (other than as an employee), Explanation 1 is also not attracted.

[3] As per section 245MA, the Central Government shall constitute, one or more Dispute Resolution Committees in accordance with the rules made under the IT Act, for dispute resolution in the case of such persons or class of persons, as may be specified by the CBDT, who may opt for dispute resolution under this Chapter in respect of dispute arising from any variation in the specified order in his case and who fulfils the specified conditions.

[4] Sanjay Baweja [W.P.(C) 11155/2023 (Delhi HC)] To read our detailed analysis, please visit https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-delhi-hc-holds-that-voluntary-payment-made-for-indemnification-of-loss

- ESOPs are not a source of revenue or profit-making apparatus for the holder because these actionable claims are, intrinsically, not capable of generating revenue (notional or actual) and cannot be monetised, whether by transfer or otherwise until shares are allotted. Even at the time of allotment, there is notional but not actual benefit. Actual benefit accrues only upon transfer provided there is a capital gain.
- The judicial precedents[5] relied upon by the taxpayer cannot be considered since therein the compensation was received in relation to the relinquishment of rights in revenue generating and subsisting capital assets, such as a managing agency or tea production factory.
- By contrast, in the case of ESOPs, the capital assets come into existence only upon allotment of shares and revenue generation from the capital asset is possible only thereafter. In this case, the compensation was not towards the loss of or even sterilisation of a profit-making apparatus but by way of a discretionary payment towards - potential, as regards Unvested Options, or actual, as regards Vested Options - diminution in value of contractual rights.
- In the absence of a contractual right to compensate for diminution in value, it cannot be said that a non-existent right was relinquished.
- Explanation (a) to Section 17(2)(vi) of the IT Act explains the scope of "specified security" by using the expression "includes the securities offered under such plan or scheme". Interestingly, the phrase 'includes the securities allotted under such plan or scheme' is not used. Therefore, "specified security", in the context of ESOPs, is not confined to allotted shares but includes securities offered to the holder of ESOPs. The use of "includes" instead of 'means' also indicates that the phrase "securities offered under such plan or scheme" is not intended to be exhaustive.
- Merely because the method of valuing the perquisite does not fit neatly into Explanation (c) to Section 17(2)(vi) of the IT Act, does not mean it cannot be taxed under the sub-head perquisites of the head "salaries" provided the value of the perquisite can be determined as per 17(2)(vi) of the IT Act. In order to determine the value of the perquisite, one should be in a position to ascertain the benefit that the employee or other person received from the specified security, albeit not by way of capital gains.
- Since shares offered under stock option schemes are either free of cost or at a concessional rate, the benefit would ordinarily be the difference between the fair market price of the share and the price at which such share is offered to the ESOP holder. Since such monetary benefit would typically be realised, albeit notionally, only at the time of exercise of the option and remains a non-monetisable contractual right until then, the fair market price of the shares as on the date of exercise of the option is reckoned and the price paid by the option holder is deducted therefrom to determine the value of the perquisite in the form of ESOP.
- In the current case, the taxpayer received a substantial monetary benefit at the pre-exercise stage by way of discretionary compensation for diminution in value of the Stock Options.
- It is not possible to discern the exercise price under the FSOP 2012 because the taxpayer has not exercised any of the options vested on the record date.
- If payments had been made by the taxpayer in relation to the ESOPs, it would have been necessary to deduct the value thereof to arrive at the value of the perquisite. Since the taxpayer did not make any payment towards the ESOPs and continues to retain all the ESOPs even after the receipt of compensation, the entire receipt qualifies as the perquisite and becomes liable to be taxed under the head "salaries".

  [Nishithkumar Mukeshkumar Mehta v. DCIT/CIT (W.P.No.26506 of 2023) (Madras HC)

Delhi HC Holds That Compensation Received For Relinquishment Of Title In Sweat Equity Is Taxable Under The Head "Capital Gains" And Not "Salaries"

The taxpayer, an individual, was employed with Tek Travels Private Limited (TTPL) for the period 1 December 2007 to 24 August 2010. In terms of his employment agreement, apart from yearly compensation, he was also entitled to sweat equity. On 8 June 2010, TTPL issued 50,000 sweat equity shares in the name of the taxpayer and thereby share certificates were also handed over. Thereafter, on 24 August 2010, TTPL terminated the taxpayer's employment. TTPL took the stand that the taxpayer was not liable to be recognised as a shareholder and refused to record his name in the Register of Members. Aggrieved, the taxpayer approached the Company Law Board (CLB) to issue directions for the registration of 50,000 shares in his name.

During the pendency of the petition before the CLB, on 23 January 2014, TTPL and the taxpayer entered into a settlement agreement pursuant to which the taxpayer received a lump sum consideration of INR 30.37mn towards full and final settlement of all disputes and differences with TTPL. Further, in terms of the Settlement Agreement, the taxpayer gave up all rights to seek enforcement of any title or interest in the said shares. While filing the tax return for FY 2013-14, the settlement amount was reported and claimed as long-term capital gain (LTCG), with the cost of acquisition being declared as "nil". The tax officer treated it as taxable under the head -Salaries.

The First Appellate Authority deleted the addition and held the amount to be taxable as capital gains. However, the Tax Tribunal bifurcated the income and held that only 15,000 shares should be treated as taxable under capital gains and the balance should be taxed under the head salaries. Aggrieved, the taxpayer filed an appeal before the Hon'ble Delhi HC. The Delhi HC, while ruling in favour of the taxpayer, made the following observations:

[5] Kettlewell Bullen & Co. Ltd. v. CIT, [1964] 53 ITR 261 (SC),
Karan Chand Thapar & Bros. Pvt. Ltd. v. CIT, (1972) 4 SCC 124
Vodafone India Services (P.) Ltd. v. UOI, (2014) 368 ITR 1(Bombay),
Godrej & Co., Godrej & Co., Bombay v. CIT, (1970) 1 SCR 527
Senairam Doongarmall v. CIT, [1961] 42 ITR 392 (SC).,
Saurashtra Cement Commissioner of Income-tax, Gujarat v. Saurashtra Cement Ltd., [2010] 325 ITR 422 (SC)
K.R.Srinath v. Assistant Commissioner of Income-Tax, judgment dated 20 April 2004 in T.C.A.No.59 of 2002

- From various clauses of the settlement agreement, it is apparent that the consideration was concerned with an unconditional and irrevocable relinquishment of the right of the taxpayer to seek and enforce the registration of the shares held by it. This is further fortified by the fact that the taxpayer undertook not to take any steps to enforce any right, title or interest in the shares.
- The settlement consideration appears to be undeniably connected with the relinquishment of all claims which could have been raised by the taxpayer in respect of sweat equity.
- “Perquisite” and “profits in lieu of salary" are dealt with separately in Section 17 of the IT Act. Sweat equity is a constituent of perquisite as per section 17(2)(vi) of the IT Act. As per section 17(3) of the IT Act, “Profits in lieu of salary", deals with compensation received by a taxpayer from his employer or former employer in connection with the termination of his employment or on a modification of terms and conditions of service.
- The employment of the taxpayer came to an end on 24 August 2010, even before the action came to be instituted before the CLB.
- Further, in the petition, which was filed before the CLB, there was no relief which was sought with respect to the cessation of employment of the taxpayer or the validity of termination of employment.
- The lump sum amount which is mentioned in Section 17(3)(iii)[6] of the IT Act would also have to draw colour and meaning from compensation received in connection with termination of employment or modification of terms and conditions of service and which are the principal subjects of “profits in lieu of salary”.
- Segregating the consideration into two components is unsustainable.

  [Akash Poddar v. ACIT (ITA 270/2023) (Delhi HC)]

Delhi Tax Tribunal Holds That Capital Gains Arising On Transfer Of Rights Are Not Taxable Under Section 9 Of The IT Act As The Situs Of A Capital Asset Not In India

The taxpayer is a Non-Resident Indian (NRI) individual and a resident of the United States of America (USA). The series of events are as follows -

DATE	EVENT
16 July 2014	The taxpayer entered into an Employment Agreement with Soft Bank Corp., a Japanese Co. and was employed with one of its group entities in the USA, being SIMI US.
17 December 2014	The taxpayer entered into a Second Amended and Restated Executive Employment Agreement with Soft Bank Corp wherein, the taxpayer was to receive fully vested Compulsory Convertible Preference Shares (CCPS) of Indian companies- Jasper Infotech Pvt. Ltd. (Snapdeal) and ANI Technologies Pvt. Ltd. (Ola).
December 2014	SIMI US acquired the CCPS of the aforementioned Indian Companies from Singapore entities at the same price at which investment was made by these Singapore entities. These entities undertook to hold the CCPS of Snapdeal and Ola in an Escrow account for the benefit of SIMI US.
29 December 2014	SIMI US assigned the rights and interest in CCPS of Snapdeal and Ola to Arora Trust at cost, a pass-through entity whose sole beneficiary was the taxpayer.
20 May 2015	Taxpayer entered into a Third Employment Agreement with Soft Bank Corp. modifying certain terms of Employment. However, the terms of allotment of shares of Indian companies remained unchanged.
1 February 2017	Taxpayer entered into a termination agreement with SIMI US for the termination of his employment. Pursuant to which, the taxpayer was paid USD 50.32mn, subject to extinguishment of interest in the CCPS.

[6] As per section 17(3)(iii) of the IT Act, any amount due to or received, whether in lump sum or otherwise, by a taxpayer from any person before his joining any employment with that person; or after cessation of his employment with that person, shall be chargeable to tax under the head salaries.

The Taxpayer offered the compensation received on extinguishment of his interest in the CCPS as LTCG. The tax officer treated the income as short-term capital gain (STCG). Aggrieved, the taxpayer filed an appeal before the Delhi Tax Tribunal. While ruling that the situs of capital asset was not situated in India, the Tribunal made the following observations:

- The second and third employment agreements do not by themselves vest any right or interest in such shares, nor do they record the acquisition of shares by the taxpayer. It is only in the nature of a promise by the employer to the taxpayer to pay employment compensation. Therefore, whether the Second Employment Agreement is a draft or a final agreement has no relevance at all for the reckoning period of holding and the third agreement makes it clear that shares have to be delivered to the taxpayer by 31 December 2014.
- Rights in the shares flow from the assignment deed dated 29 December 2014, in terms of which, SIMI US assigned the rights and interests in the CCPS in favour of the taxpayer through Arora Trust.
- The termination agreement dated 1 February 2017 makes it absolutely clear that the shares were never physically transferred to the taxpayer. By virtue of the termination agreement, the rights and interests in CCPS accrued to the taxpayer were transferred and extinguished in terms of section 2(47) of the IT Act.
- The compensation of CCPS as per the assignment deed was offered to tax by the taxpayer in his US tax return.
- CBDT Circular no.704, dated 28 April 1995 explains the meaning of the period of holding under section 2(42A)[7] of the IT Act. It has been clarified by the Board that the date of broker notes or date of the contract of sale shall be relevant for determining a period of holding subject to the actual delivery of share subsequently. Since the shares were never delivered in the name of the taxpayer, it cannot be said that the taxpayer had held any capital asset in the nature of the share or security of an Indian company so as to get the benefit of the third proviso to section 2(42A) of the Act.
- Factually, the rights and interests acquired by the taxpayer under the assignment deed were held for a period of less than 36 months. Therefore, the capital asset transferred by the taxpayer has to be treated as a short-term capital asset.
- As it is established that the taxpayer transferred a capital asset in the nature of certain rights and interests and not any shares of Indian companies, it cannot be said that the capital gain derived by the taxpayer was through a transfer of capital assets situated in India.
- The situs of capital asset in the nature of rights and interests acquired by the taxpayer, which were subsequently transferred and subjected to capital gain, was in the USA and not located in India. Therefore, in terms of section 9(1)(i)(a) of the IT Act, the income derived from the transfer of such capital asset is not taxable in India.
- In the termination agreement, it has been clearly stipulated that the payments to be received by the taxpayer towards the transfer of his rights and interests will represent capital gain taxable under the domestic law of India and has to be offered to tax by the taxpayer by filing a tax return in India. Therefore, the tax return filed by the taxpayer offering to tax the LTCG is strictly in compliance with the terms of the termination agreement and the taxpayer is entitled to relief only to the extent of claims made in the tax return.

[Nikesh Arora (ITA No.1008/Del/2022) (Delhi ITAT)]

Delhi HC Holds TRC To Be Sacrosanct In Absence Of Fraud/ Sham

Taxpayer, a Mauritian company, was set up with the primary objective of undertaking investment activities with the intention of earning long-term capital appreciation and investment income. The taxpayer has been granted a Category 1 Global Business License and its activities are regulated by the Financial Services Commission of Mauritius. Further, the taxpayer has received a Tax Residence Certificate from the Mauritius Revenue Authorities.

The immediate shareholders of the taxpayer are also Mauritian companies whose shareholders in turn are private equity funds who had raised funds from several investors across the globe. The indirect shareholders of the taxpayer consisted of almost 500 investors residing in as many as 30 jurisdictions globally. Tiger Global Management LLC (TGM LLC), a company incorporated in Delaware USA, was the taxpayer's Investment Manager. TGM LLC had not placed any investments with the taxpayer and neither TGM LLC nor any of its affiliates have either invested in the taxpayer or the private equity funds that had indirectly invested with them.

The taxpayer had acquired 2,36,70,710 shares of Flipkart Singapore between October 2011 and April 2015. Further, on 9 May 2018, a Share Purchase Agreement was executed between Walmart International Holdings, Inc., a Delaware Corporation (purchaser) and the shareholders of Flipkart Singapore (seller) and Fortis Advisors LLC, a Delaware limited liability company (seller's representative). As per the SPA, the sale of the shares held by the taxpayer is approved by the Board in its meeting held on 4 May 2018.

As Flipkart Singapore substantially derived its value from India, the taxpayer approached the Indian Revenue Authorities to issue a nil tax withholding certificate under section 197 of the IT Act. However, the Indian Tax Officer declined to issue a nil withholding certificate as it was of the opinion that the taxpayer was not independent in its decision-making with regard to various capital assets held by it. Thereby, the tax authorities issued the Certificate under section 197 of the IT Act directing the Buyer to withhold tax at rates which vary from 6.05% (exclusive of surcharge and cess) on the consideration payable to the taxpayer in respect of the transfer.

[7] As per third proviso to section 2(42A) of the IT Act, in the case of a share of a company (not being a share listed in a recognised stock exchange in India), [or an immovable property, being land or building or both,] short term capital asset means a capital asset held by a taxpayer for not more than twenty-four months.

On 18 August 2018, the taxpayer transferred their shareholding in Flipkart Singapore to Fit Holdings SARL, a Luxembourg entity. Thereafter the taxpayer approached the Authority for Advance Ruling (AAR) on 19 February 2019 seeking its opinion on the taxability of the transaction in question. AAR came to the conclusion that the transaction was entered into with the intent to derive benefits from the DTAA in a manner which was never intended by the two contracting States and that consequently clause (iii) of the Proviso to Section 245R(2) would be attracted and thereby rejected taxpayer's application. Aggrieved, the taxpayer filed an appeal before the Delhi HC.

While granting the benefit of the DTAA and thereby exempting capital gains from taxation in India, the Delhi HC made the following observations:

- The entire case as set up against the taxpayer appears to suffer from a wholly erroneous and factually unsustainable premise of TGM LLC being the holding and the parent company. Neither the AAR nor the Indian Revenue Authorities have been able to dislodge or cast doubt on the role and position of TGM LLC as advocated and asserted by the taxpayers.
- Despite its position having been duly disclosed in the original application itself and the taxpayer having denied the role ascribed to TGM LLC by the Indian Revenue Authorities, the AAR has erroneously proceeded on the premise that it was the parent and holding company. While proceeding on the basis of a perceived admission, the AAR also failed to verify the facts which were evident from a perusal of the Financial Statements which formed part of its record, and which had duly disclosed the identity of the principal shareholders of the taxpayers.
- The establishment of investment vehicles in tax-friendly jurisdictions cannot be considered to be an anomaly or give rise to a presumption of being situated in those destinations for the purpose of evading tax or engaging in treaty abuse.
- The principles of substance over form must be considered to be the prevailing norm and the Revenue Authorities are entitled to doubt the bona fides of a transaction only in those situations where it is found that the transaction involves a sham device intended to achieve illegal objectives or formulated based on illegal motives.

Mauritius Route

- Azadi Bachao Andolan[8] had come to be pronounced at a time when the DTAA did not incorporate a LOB provision. While noticing this aspect, the Supreme Court (SC) observed that, unlike other tax treaties which embodied Articles which regulated or constituted limitations with respect to treaty benefits being availed, the India-Mauritius DTAA contained no disabling conditions. It proceeded to hold that where the terms of a taxing convention were applicable, notwithstanding courts being otherwise empowered to peer through the veil of incorporation, the said principle would be inapplicable. The Court thus proceeded to negate the submission of incorporation of entities in Mauritius being liable to be doubted or frowned upon.

Favourable Tax Jurisdictions

- Out of the bulk of the FDI headed towards India in 2012, as was noted in Azadi Bachao Andolan, almost 50% of the same originated from Mauritius. The data and the facts noticed above lead us to the irresistible conclusion that it would be wholly incorrect to presume investments originating from that nation as being inherently dubious or disreputable. Thus, the mere fiscal residence of an entity in Mauritius would not give rise to a presumption of infamy or constrain courts to approach such investments through what is metaphorically referred to as tinted lenses.
- The Supreme Court in unequivocal terms held that there was nothing inherently abhorrent in treaty shopping given the economic compulsions of nations who are desirous of attracting foreign investment. The decision clearly appears to hold and suggests that while treaty shopping may be permissible, nations have chosen to adopt a system of checks and balances to ensure that there is no significant revenue loss or treaty abuse.
- While repelling the argument of entities in Mauritius being mere shells and of treaty shopping being unethical, the SC in Azadi Bachao Andolan held that if the contracting states intended to deprive a particular category of entities of the benefits of the convention, it would have been reasonably expected that a LoB provision were incorporated. The SC took note of the DTAA as it stood then in contrast to other conventions, and which provided for appropriate disqualifications.
- The first seeds of doubt pertaining to capital gains arising out of the alienation of shares were considered in Circular No. 682 of 1994. The Union Government clarified that any gains derived by a Mauritian resident from alienation of shares would be taxable only in Mauritius. Many years before the introduction of Section 90(4) and Rule 21AB in the Income Tax Rules 1962 (IT Rules), the Indian Government clarified vide Circular No. 789 of 2000 that a Tax Residency Certificate (TRC) would constitute sufficient evidence for accepting status of residence and beneficial ownership. Of seminal import were the amendments which were sought to be pushed through by virtue of Finance Bill 2013 and which sought to insert a provision in Section 90 intending to proclaim that while a TRC would be necessary to avail of treaty benefits, it would not constitute a sufficient basis for claiming benefits. The said amendment was ultimately withdrawn as a consequence of a huge furore and the resounding negative clamour and opposition which came to be voiced in connection therewith.

Tax Residency Certificate

- The significance and the salutary purpose underlying the issuance of a TRC cannot be overemphasised. Its importance stands duly acknowledged by the Union Government itself as is manifest from a reading of Circular 789 of 2000. Of equal import is the withdrawal of the amendments which were proposed to be introduced in Section 90 and were ultimately shelved. It becomes important to note that a TRC once found to have been issued by the competent authority must be accorded due weightage and its sanctity duly acknowledged.

[8] UOI v. Azadi Bachao Andolan 263 ITR 706 (SC)

- The TRC represents the first level of certification of the holder being a bona fide business entity domiciled in the residence country. The issuance of a TRC constitutes a mechanism adopted by the residence country itself so as to dispel any speculation with respect to the fiscal residence of an entity. It therefore can neither be cursorily ignored nor would the revenue be justified in doubting the presumption of validity which stands attached to that certificate bearing in mind the position taken by the Union itself of it constituting sufficient evidence of lawful and bona fide residence.
- The issuance of a TRC by a country must be considered to be sacrosanct and due weightage must be accorded to the same as it constitutes certification of the TRC holding entity being a bona fide entity having beneficial ownership domiciled in the said country to pursue a legitimate business purpose in the said country.
- The circumstances under which the Revenue Authorities could pierce the corporate veil of a TRC holding entity is restricted to extremely narrow circumstances of tax fraud, sham transactions, camouflaging of illegal activities and the complete absence of economic substance and the establishment of those charges would have to meet stringent and onerous standards of proof and the Revenue Authorities being required to base such conclusions on cogent and convincing evidence and not suspicion alone. It is only when the Revenue Authorities is able to meet such a threshold that it can disregard the presumption of validity which would be attracted the moment the TRC is produced and LOB conditions are fulfilled.

International Perspective of Treaty Shopping

- Action 6 of the BEPS Action Plan was principally concerned with the development of treaty provisions which would prevent the extension of benefits in inappropriate circumstances. Action 6 was responsible for the adoption of measures such as LOB clauses in treaties and the evolution of the Principal Purpose Test (PPT). As is evident from a reading of the OECD Commentary on Article 29 which deals with Entitlement to Benefits, treaties incorporate disentitlement provisions to deprive persons who are otherwise not entitled to treaty benefits and who may adopt indirect methods to avail of those benefits and thus violate the bilateral and reciprocal understanding of the Countries and which constitutes the foundation of all conventions. Even the Commentary recognises and acknowledges the establishment of an entity for legitimate business reasons. It goes on to explain that where entities resident in a country undertake business activities in that country, it would be inappropriate to characterise its activities as constituting treaty shopping.
- The position which emerges is that revenue authorities across various jurisdictions appear to have taken the consistent position of treaty benefits being liable to be denied in cases where fraud is sought to be perpetrated, where the transaction is a mere sham, entities are mere dummies and have come to be created to merely act as conduits and where the extension of benefits would be contrary to the object and purpose of the treaty itself. However, a conclusion in that respect cannot be based on some unstated presumption of invalidity or founded upon a failure to holistically examine the transaction as a whole and the Revenue Authorities coming to the irresistible and justifiable conclusion that the sole intent of the transaction was to evade taxes, perpetuate an illegality and to obtain an inappropriate advantage. A finding based on objective evidence that the activity would fall in the category of an abusive transaction would constitute a sin qua non and a legal imperative before the denial of benefits or the rendering of a verdict of disentitlement.

LOB Provision in DTAA

- The DTAA, post its amendment in 2016 and the insertion of Article 27A and with sufficient clarity enumerates the circumstances in which an entity may be denied benefits of Article 13(3B) or where it would be deemed to be a mere shell/conduit company. It defines a shell/conduit company as being one with negligible or nil business operations or one which fails to exhibit the carrying on of a real and continuous business. Article 27A not only lays in place a criterion where an entity would be deemed to be a shell or a mere conduit as well as contingencies in which a negative legal fiction would operate and dispel any assumption of that entity being a shell or a mere artifice. The DTAA thus specifically adopts provisions concerned with entitlement to benefits and thus embodies standards and tests that both Countries chose to adopt for the purposes of tackling instances of treaty shopping and abuse.
- Once LOB provisions come to be incorporated in a tax treaty, it would be those provisions which would govern and be determinative of an allegation of treaty abuse or a benefit being illegitimately claimed. The doubts of the Revenue Authorities or the material that it may gather in support of its allegation of abuse would have to be demonstrative of the LOB provision being breached or violated. The right to question the validity or character of a transaction notwithstanding duly articulated LOB provisions being met would have to meet an extremely high, exacting and compelling standard of proof with the onus lying squarely upon the Revenue Authorities to establish that the substance of the transaction clearly warrants the entity being deprived of treaty benefits. These would stand confined to cases of fraud or sham, transactions tainted with illegality and where circumstances unerringly prove that the Countries never intended it to be covered by the beneficial treaty provisions.
- The TRC as well as the LOB provisions comprised in the DTAA more than adequately, nay comprehensively, address themselves to treaty abuse and it would thus be wholly impermissible for the Revenue Authorities to construct additional barriers or qualification standards for the purposes of extending benefits under the DTAA. This would of course be subject to the limited caveat and narrow confines of fraud, illegal activity or where the transaction is contrary to the underlying objective and purpose of the treaty itself.

- Article 27A came to be included in the DTAA at a time when Chapter X-A had already come to exist on the statute book in terms of Finance Act, 2013 and with effect from 1 April 2016. India and Mauritius, being aware of the aforesaid as well as other significant amendments, including those pertaining to taxation of indirect transfers, made to the IT Act chose to grandfather all transactions pertaining to alienation of shares and which had been consummated prior to 1 April 2017. What we seek to emphasise is the Contracting States being fully conscious of the legislative amendments which had occurred in their respective taxing statutes and chose to renegotiate the terms of the treaty in that light.
- The Contracting States did not intend for domestic taxation authorities to deploy their own subjective standards in view of the enactment of LOB provisions which had also adopted ascertainable standards to defenestrate presumptions of treaty abuse. It is the finding of this Court that taking any view to the contrary would amount to privileging domestic legislation over and above the enactments in the treaty provisions adopted by contracting states and would amount to holding that jurisdiction inheres in taxing authorities to question the validity of transaction on parameters alien to the negotiated terms of the treaty.
- LOB provisions and the TRC comprehensively and adequately address concerns in relation to potential treaty abuse and it would be impermissible for the Revenue Authorities to manufacture additional roadblocks or standards that parties would be required to meet in order to avail of DTAA benefits, subject to caveats of illegality, fraud and the transaction being in contravention of the underlying object and purpose of the treaty.

GAAR

- Chapter X-A would be inapplicable in light of Article 13(3A) of the DTAA which grandfathers all acquisitions prior to 1 April 2017. The clear intent of India and Mauritius to ring-fence those transactions is evident not just from the plain language of Article 13(3A) but additionally fortified by the stated language of Rule 10U(1)(d) of the IT Rules.
- Rule 10U(2) of the IT Rules does not override or eclipse the protection accorded by Rule 10U(1)(d) of the IT Rules.

Beneficial Ownership

- The principles of beneficial ownership itself would have arisen provided it was established that the taxpayers were contractually or otherwise acting on behalf of TGM LLC and were enjoined to remit all revenues generated by the transaction in question to a third party. The principle of beneficial ownership would have been attracted provided the Indian Revenue Authorities were able to establish that the taxpayers were placed under a contractual or legal obligation to pass on the payments received to another entity.
- The OECD Model Commentary canvasses a position where beneficial ownership and aspects pertaining thereto would have to be evaluated on the basis of the *"forwarding approach"*.
- If it were found that the conduit was able to avail the income itself and was not contractually obligated to forward that income to another person, it would clearly be incorrect to impute the principles of beneficial ownership in such a contextual setting. The core of the aforesaid precepts would appear to be aspects of ownership and control over the income, a right of disposal or a contractual obligation to pass on the same to another.
- Both Vogel and Baker bid us to ascertain and discern the true controller of the income, the entity which decides the use of the asset and the income, and which could also include an administrator or trustee.
- Tested on the basic rule of substance over form, the concept of the beneficial owner would get attracted to cases where the recipient of income or the holder of the asset is found to be merely the ostensible depository and which may hold the income either in the capacity of an administrator or even as a trustee. For this charge to be accepted, it would have to be established that the recipient or holder of income has no right or control over the income and merely holds the same to be deployed on the instruction of another. While the obligation to forward the income or gain may be either legal or contractual dependent upon the position of parties, it would certainly require a finding on the fact that the income is held at the behest of another, is controlled and regulated by a third party entity and the ostensible owner having no real or substantive control over the same.
- A parent or holding company would legitimately claim the right to exercise oversight and retain a broad supervisory role over the affairs of its subsidiaries. This could legitimately take the shape of seats on the Board of Directors (BoD), placement or selection of key managerial personnel, regular audit of the affairs of the subsidiary or a periodical review and reporting process. These aspects were duly acknowledged and highlighted by the SC in Vodafone which recognised the well-settled position of companies and other incorporated entities being viewed as economic entities with legal independence. While dealing with the control that may be exercised by a group parent company, it was observed that merely because the parent may exercise shareholder influence over its subsidiary would not lead one to draw an adverse inference of the latter being a mere puppet.
- Merely because two of the members of the Board also happened to be connected with the larger conglomerate would not convince us to hold that the taxpayers were reduced to mere puppets.
- The concept of beneficial ownership would get attracted if it be established that the holder of income had no control over the income and merely holds the same till such time it be instructed to deploy that income to another entity or if the income is controlled or regulated by a third party with the holder having no real or substantive control over that income.

Tiger Global International II Holdings and Others vs. AAR (Income tax and Ors) [W.P.(C) 6765/2020]

INDIRECT TAX

Tax Invoices, E-Way Bill and bank payments cannot prove the actual movement of goods for claiming input tax credit (ITC)

Anil Rice Mill Vs. State of U.P. & Ors. [TS-527-HC(ALL)-2024-GST]

Facts of the case

- M/s. Anil Rice Mill (Taxpayer) is engaged in the business of trading peanuts, galla and paddy.
- The Taxpayer had received a show cause notice (SCN) under Section 74 of the Central Goods and Services Tax Act, 2017 (CGST Act) alleging that the Taxpayer had claimed the wrong ITC for the months of June to September 2020.
- After considering the response filed by the Taxpayer, the aforesaid SCN was confirmed vide the Order-in-Original. Against this, the Taxpayer filed an appeal before the First Appellate Authority which was rejected.
- Aggrieved by the above, the Taxpayer filed a Writ Petition before the Allahabad High Court.

Contention of the Taxpayer

- The Taxpayer has claimed ITC after the due purchase of goods through a proper invoice and had made the payment through the banking channel. Merely because the supplier has not reported the said purchases in its returns or has not deposited tax, action cannot be initiated against the Taxpayer.
- Since the Taxpayer had cleared the invoice issued by the supplier on which tax was charged, the benefit of ITC cannot be legally denied to the Taxpayer.
- The ITC under the GST regime is introduced to avoid cascading effect and once the tax charged on the invoice is paid by the Taxpayer through the banking channel, the benefit of the ITC cannot be legally denied.
- The Taxpayer has rightly discharged his liability of tax by paying the same to the supplier and if the supplier has not deposited the tax so charged, the supplier ought to be penalised and not the Taxpayer. The recovery of ITC that is rightly claimed by the Taxpayer would amount to double taxation which is not aligned with the spirit of the GST regime.
- Reliance in this regard was placed on ***Commissioner of Central Excise Customs and Service Tax Vs. M/s Juhi Alloys [CE Appeal 21 of 2014] and LGW Industries Ltd. and Ors. Vs. Union of India*** and ***Ors. [WPA No. 23512 of 2019]***.

Observation and ruling of the High Court

- The scheme of ITC is introduced with an object to avoid the cascading effect of tax and to avoid double taxation. The benefit of concession / ITC under the tax statute can be availed only on the fulfilment of certain conditions or restrictions. In the event of a breach of any of the conditions, no benefit can be conferred to the dealer.
- On perusal of Section 16(2) of the CGST Act, it is clear that a registered dealer can claim ITC only on fulfilment of certain conditions enumerated therein.
- Further, on a combined reading of Sections 16(2) and 74 of the CGST Act, it is evident that in the event of wrong availment of ITC, proceedings can be initiated against

the registered person. However, restrictions have been imposed upon the authorities that without sending a notice to the dealer, no adjudication proceedings can be initiated.

- The Taxpayer has only brought on record the tax invoices, e-way bills and payment through the banking channel, but no details such as payment of freight charges, acknowledgement of taking delivery of goods, toll receipts and payment thereof have been provided. Thus, in the absence of these documents, the actual physical movement of goods cannot be established and the genuineness of transportation of goods and the transaction cannot be established. Further, no proof of filing of Form GSTR-2A has been brought on record and hence, the proceedings have been rightly initiated against the Taxpayer.
- Reliance was placed on the Supreme Court ruling in the ***State of Karnataka Vs. M/s. Ecom Gill Coffee Trading Pvt. Ltd. [Civil Appeal No. 230 of 2023]*** wherein it was held that primarily the burden of proof for claiming ITC is upon the dealer, i.e., to furnish the details of the selling dealer, vehicle number, payment of freight charges, acknowledgement of taking delivery of goods, tax invoices and payment particulars to prove and establish the actual movement of goods. A similar view was held by the Calcutta High Court in ***M/s. Shiv Trading Vs. State of U.P. and Ors. [Writ Tax No. 1421/2022]***.
- In view of the above, the Writ Petition filed by the Taxpayer was set aside and the Impugned Order was upheld.

Fixed establishment registered outside India under foreign law does not imply a separate establishment

Sri Avantika Contractors (I) Ltd vs Appellate Authority for Advance Ruling & Ors. [TS-476-HC(TEL)-2024-GST]

Facts of the case

- The Government of India (GoI) has entered into an agreement with the Government of Maldives (GoM) to construct a police academy. In turn, GoI has appointed National Building Construction Corporation Ltd (NBCCL) to execute the above contract by itself or through a contractor. Subsequently, NBCCL has awarded the contract to Sri Avantika Contractors Ltd. (Taxpayer).
- In order to complete the work in Maldives, NBCCL and the Taxpayer had set up their office in Maldives. The Authorised Dealer bank (Oriental Bank of Commerce (OBC)) acting on behalf of the Reserve Bank of India approved the establishment of the Taxpayer's branch office in the Maldives.
- For compliance with Maldivian Laws, the Taxpayer obtained a 'Certificate of Re-registration' issued by the Registrar of Companies, Maldives. Further, the Taxpayer has also entered into a rental agreement to have a 'fixed establishment' in Maldives.
- During the construction of the building, the Taxpayer obtained employment approval from GoM. Further, the Taxpayer had also obtained GST registration under the Maldivian GST law. Further, the consideration for the project will be paid by NBCCL in Indian Rupees against the submission of running bills passed during the progress of the project.
- Based on the contractual arrangements, the taxes paid by the Taxpayer and NBCCL will be reimbursed by NBCCL and GoI respectively. In this regard, NBCCL had obtained a legal opinion where it was opined that the project under consideration is neither taxable under the Service tax regime nor under the GST regime.
- However, the Taxpayer filed an application before the Authority for Advance Ruling (AAR) to determine the liability to pay GST in respect of the aforesaid contract. The AAR held that the consideration received by the Taxpayer is leviable to GST.
- Against this, the Taxpayer preferred an appeal before the Appellate Authority for Advance Ruling (AAAR). However, AAAR rejected the appeal filed by the Taxpayer and upheld the order passed by AAR.
- Aggrieved by the above, the Taxpayer filed a Writ Petition challenging the order passed by AAAR.

Contentions of the Taxpayer

- The AAR and AAAR have erred in passing the Impugned Advance Ruling order and affirming the same in the appeal. The aim and object of the GST law demonstrate that the GST law never intended to apply beyond the territory of India. By no stretch of the imagination, the definition of the term 'India' under Section 2(56) of the CGST Act would be interpreted to include works contract service provided by the Taxpayer in Maldives.

- GST is not applicable beyond the territory of India and in relation to the 'works contract' service provided by the Taxpayer through its fixed establishment situated in Maldives. The location of the supplier, in the present case, would be the location of the 'fixed establishment' in Maldives and not the Taxpayer's registered office in Telangana.
- Even if it is assumed that GST is leviable in the present scenario, the GST amount would be reimbursed by GoI to NBCCL and in turn by NBCCL to the Taxpayer. Thus, money will go from one pocket of the Government to another. Further, the Taxpayer cannot be made to suffer and pay GST on the activity carried out in Maldives.
- The Taxpayer has already paid GST as per the Maldivian laws. The object behind enacting the GST laws is to levy tax for the activity that takes place within the territory of India and not outside India.
- The Impugned Advance Ruling is cryptic in nature and does not deal with certain statutory provisions of the CGST Act and IGST Act. The impugned orders will make the Taxpayer almost remediless so far in-house mechanism under the GST law is concerned. Once the advance ruling is issued and the same is affirmed by the AAAR, in any proceeding under the GST law, the tax authorities will be influenced, guided and prejudiced by the said advance ruling.
- It is submitted that the Taxpayer and NBCCL have established their 'fixed establishment' in Maldives. A huge construction of the building had taken place in the Maldives which took several years. During this time, through their 'fixed establishments', the Taxpayer and NBCCL have monitored and executed the work and have taken care of all Ministerial activities arising thereto.
- The Taxpayer's re-registration in Maldives was an essential requirement of the Maldivian law. The said re-registration does not mean that a new or separate legal entity came into being. At best, at a new location i.e., a 'fixed establishment' was created and a bare perusal of proviso to Section 12(3) of the IGST Act makes it clear that the rulings by AAR and AAAR are bad in law.

Contentions of the tax authorities

- On perusal of the definition of the terms 'recipient', 'location of the recipient of service', 'location of the supplier of services', 'fixed establishment' and 'persons', it can be construed that –
  - **Recipient [Section 2(93) of the CGST Act]:** Since the consideration was payable by NBCCL which is located and registered in New Delhi, India, NBCCL would be treated as the recipient of services.
  - **Location of the recipient of services [Section 2(14) of the Integrated Goods and Services Tax Act, 2017 (IGST Act)]:** Since the supply is received by NBCCL at a place of business for which GST registration is obtained by NBCCL, i.e., in New Delhi, the same shall be treated as the location of the recipient of service.
  - **Location of supplier of services [Section 2(15) of the IGST Act]:** Since the supply is made by the Taxpayer from a place of business for which GST registration is obtained, i.e., from Hyderabad, the same shall be treated as the location of the recipient of service.
  - **Person [Section 2(84) of the CGST Act read with Section 2 of the Companies Act, 2013]:** A company is a company incorporated in India and a foreign company is a company incorporated outside India. Hence, both are separate 'persons' and separate legal entities.
- Considering the definition of 'fixed establishment', the Taxpayer's registered place in Maldives cannot be considered as the Taxpayer's 'fixed establishment'.
- It is undisputed that the work performed by the Taxpayer in the Maldives is a 'works contract' as per Section 2 (119) of the CGST Act and relates to a contract of services, yet 'works contract' is a contract. The contract is between the Taxpayer and NBCCL and both the 'supplier' and the 'recipient' are situated in India.
- Since the Taxpayer has filed their returns by declaring the services rendered as 'zero rated supply' (exports), the Taxpayer's contention that they were in Maldives for the purpose of the GST law cannot be accepted. Further, the petitioner has not received any payment in convertible foreign exchange and hence, the present Writ Petition deserves to be dismissed.
- As per Section 12(3) of the IGST Act, although the location of immovable property is in Maldives, the place of supply would be the location of the recipient, i.e., NBCCL, New Delhi. Further, since the supplier and the recipient are situated in India, Section 13 of the IGST Act is not applicable to the present case.
- It is well settled that the High Court is not required to sit in appeal and re-evaluate the entire flow of things. Basically, flaws in the decision-making process, perversity in decision and where the impugned decision is such, which no reasonable person can reach alone can form the basis for interference. Even if two views are possible, one of which has been taken in the impugned order, no interference is warranted.
- Section 12(3) of the IGST Act cannot be read in the manner as suggested by the Taxpayer. The location of the recipient must be treated as New Delhi and cannot be treated as Maldives. Further, the Taxpayer has only challenged the order passed by AAAR and not assailed the order passed by AAR.

Observations and ruling of the High Court

- The expression 'registered place' means registration under Indian laws. The registration under Maldivian law is not covered under Section 2(7) of the IGST Act. The necessary ingredients to treat the establishment of the Taxpayer and NBCCL as fixed establishments are available which brings them within the definition of 'fixed establishment' as there exists a sufficient degree of permanence of such establishments which were used for several years for construction of the building.

- Further, there exists a suitable structure/office in terms of human and technical resources to supply services or receive the same. Further, a sizeable number of human and technical resources were employed in the Maldives for completing the task. Thus, the establishments situated in the Maldives, which are other than the place of registration of business of the Taxpayer and NBCCL are fixed establishments under the GST law.
- The words 'registered place' mentioned under Section 2(7) of the IGST Act does not mean 're-registration' under foreign law of different jurisdictions. Further, the nature of 're-registration' of the Taxpayer needs to be investigated. On perusal of the Certificate of Re-registration and Section 94(a) of the Companies Act of the Republic of Maldives, it appears that –
  - An existing company registered outside Maldives is required to get itself 're-registered' before commencing any business in Maldives.
  - Certificate of Re-registration was obtained by Taxpayer as required by Section 94(a).

  Thus, it is difficult to hold that merely because the petitioner got a Certificate of Re-registration under Maldivian law, the Maldivian entity became a separate legal entity or person.
- Mere re-registration under the Maldivian Laws does not result in the creation of a separate legal entity. Further, there is no agreement to the effect that the said 'separate entity' could execute the agreement. Thus, it cannot be held that the works contract services were rendered by a separate entity.
- The AAAR erred in holding that from where services were supplied pursuant to the 'works contract' is immaterial. This finding runs contrary to the statutory provisions. The place where supply is received is certainly the determinative factor and learned AAAR has gone wrong in holding that the said aspect is immaterial. The 'works contract services' were supplied and received in Maldives and not at Hyderabad or New Delhi where registered offices of the Taxpayer and NBCCL respectively are situated.
- The supply in the instant case is admittedly received by the 'fixed establishment' of NBCCL at Maldives. No registration of recipient under Indian law was made separately for the establishment of NBCCL at Maldives. Thus, it was received at a 'fixed establishment', i.e., at a place other than the place of business for which registration was obtained, i.e., New Delhi.
- A combined reading of Explanations 1 and 2 to Section 8 of the IGST Act shows that if the Taxpayer had any 'establishment' in the Maldives, it must be treated as his 'establishment' in that territory and such establishment shall be treated as an 'establishment' of a distinct person. Once such 'fixed establishment' is treated as an establishment of a distinct person and treated as his 'representational office' in another territory, it will be clear that 'works contract services' performed by the Taxpayer are related to the 'establishment' of the Taxpayer in India and his 'fixed establishment' in the Maldives is his other establishment or 'representational office'.
- The Maldivian establishment being treated as an establishment of a distinct person mentioned in Explanation I will not mean that the Taxpayer's Maldivian establishment is a separate and independent legal entity as held by the AAAR. At best, it may be treated as an artificial juridical person as per Section 2(84) of the CGST Act. Similarly, the location of the Taxpayer's registered office in Hyderabad or NBCCL's office in New Delhi will not be the decisive factor.
- If the aforesaid explanations to Section 8 of the IGST Act are read conjointly with Section 2(14)(b) and 2(15)(b) of the IGST Act, the conclusion will inevitably be that the 'establishments' of the Taxpayer and NBCCL were 'fixed establishments' in Maldives as they were not situated at the place of the registered place of business of the taxpayer and NBCCL, i.e., Hyderabad and New Delhi respectively.
- Even if place of supply is to be determined as per Section 12(3) of the IGST Act, as per proviso to Section 12(3) of the IGST Act, place of supply will be the location of the recipient, i.e., Maldives.
- Section 13(4) of the IGST Act provides that the 'place of supply' in relation to an immovable property, for carrying out construction work, shall be the place where the immovable property is located. Section 13 is clear and unambiguous and hence, must be given effect irrespective of its consequences. In the present case, since the supply of service, location of recipient and supplier is outside India, the question of levy and collection of GST does not arise.
- In view of the above, the Writ Petition was allowed, and the orders passed by the AAR and AAAR were set aside. The amount of GST, interest and penalty (if any) deposited by the Taxpayer in respect of construction services provided in Maldives was to be refunded in a time-bound manner.

Pending Investigation Before The State GST Authorities Cannot Be Transferred To DGGI 'Merely' Based On New Information About Fraudulent ITC

Stalwart Alloys India Pvt. Ltd. Vs. UOI [Ts-534-hc(p&h)-2024-gst]

Facts of the case

- Stalwart Alloys India Pvt. Ltd. (Taxpayer) is a manufacturer of lead alloys, lead pure in the shape of ingots, lead sub-oxide and red lead.
- An enquiry was initiated by the Haryana State Goods and Services Tax Department (HGST Department) as well as by the multiple Directorate General of GST Intelligence (DGGI) Zonal Units with regard to wrongful availment of ITC.
- Against this, the Taxpayer filed a Writ Petition which was disposed of with a direction to the tax authorities to conduct proceedings by one agency alone for the period from 1 July 2017 to 31 December 2018. Accordingly, the HGST department had decided to take up the enquiry proceedings against the taxpayer and consequently, various records including ledger accounts, sales and purchase invoices, proof of payment, etc. were requisitioned by the tax authorities. Subsequently, a show cause notice was also issued under Section 74(1) of the CGST Act.
- The DGGI had gathered intelligence in respect of a racket involving the passing of ITC to various beneficiaries (including the Taxpayer) without supply of underlying goods/services. All the suspicious suppliers were found to be non-existent/ non-operational.
- Pursuant to the aforesaid proceedings, the DGGI observed that Anant Rastogi had created and operated various fake firms through which ITC was passed on to various beneficiaries including the Taxpayer during the period from September 2019 to February 2021. Pursuant to this, Anant Rastogi was apprehended and his statement was recorded wherein he had confessed to the aforesaid *modus operandi*. The Taxpayer was also stated to be actively involved with Anant Rastogi.
- Subsequently, DGGI conducted search and seizure proceedings and in Panchnama, it was mentioned that the records and documents had already been seized by the HGST Department. In this regard, the Principal Director (Intelligence), DGGI had issued a letter and granted permission to the office of DGGI, Meerut Zonal Unit (MZU) to conduct the centralised investigation against the Taxpayer after 2019.
- Consequently, another search and seizure proceedings were conducted at the Taxpayer's premises by the DGGI, MZU and subsequently, the HGST Department transferred the proceedings pertaining to the Taxpayer to the DGGI, MZU.
- Aggrieved by the aforesaid transfer of all proceedings to DGGI, MZU, the Taxpayer filed a Writ Petition before the Punjab & Haryana High Court.

Contention of the Taxpayer

- The action on the part of the HGST Department is in violation of Section 6(2)(b) of the CGST Act. The proper officer in the present case would be the officer who had initiated proceedings under Section 74(2) of the CGST Act. Further, multiple proceedings cannot be allowed to continue and the proper officer in the present case would be the HGST Department alone who has the jurisdiction to examine the subject matter.
- Once the records have been seized by the HGST Department at the instance of DGGI, the record cannot be transferred to the office of DGGI nor can DGGI usurp the power of the officer of the HGST Department.
- Reliance in this regard was placed on Circular dated 5 October 2018, ***RCI Industries & Technologies Ltd. Vs. Commissioner DGST, Delhi and Ors. [2021 SCC OnLine 3450] and Ideal Unique Realtors (P) Ltd. and Ors. Vs. Union of India and Ors. [2023 (108) GSTR 105 (Cal.)]***.
- It is well settled that the issue of jurisdiction can be raised at any stage. Further, the commencement of investigation under Section 67 of the CGST Act can be said to be the start of proceedings to safeguard government revenue. Therefore, once the proceedings have been started at the State level and notice has been issued under Section 74(1) of the CGST Act, it would only be legal for the State authorities to conduct intelligence proceedings. Unlike the provisions under the Income Tax Act, 1961, Central Excise Act, 1944, Customs Act, 1962 and the Central Sales Tax Act, 1956, the provisions of the GST law do not permit the transfer of a case with the permission of the Principal Director General/ Chief Commissioner/ Commissioner or the Director General/ Chief Commissioner/ Commissioner. Accordingly, in the absence of the power to transfer the proceedings to DGGI, the transfer of proceedings by the HGST Department to the DGGI, MZU is unsustainable in law.

Contentions of the tax authorities

- As regards the period after 2019, the HGST Department has not taken any steps to conduct an investigation. Further, the earlier order of the High Court in the present matter only pertains to overlapping periods till 31 December 2018.
- Since the suspicious suppliers are not registered in Haryana and the statement of Anant Rastogi is of relevance, the Taxpayer appears to be *prima facie* involved in claiming fraudulent ITC. Accordingly, it would be in the interest of justice if the enquiry was conducted by DGGI, MZU.
- After detailed deliberation, it was decided that the HGST Department would examine the action of the previous year and for the subsequent period, action is to be taken by the Central GST authorities, if they have received any information. Accordingly, no investigation has been conducted by the HGST Department for the period from July 2019 to March 2022 and the DGGI MZU or the Central GST authorities ought not be prevented from conducting further proceedings.

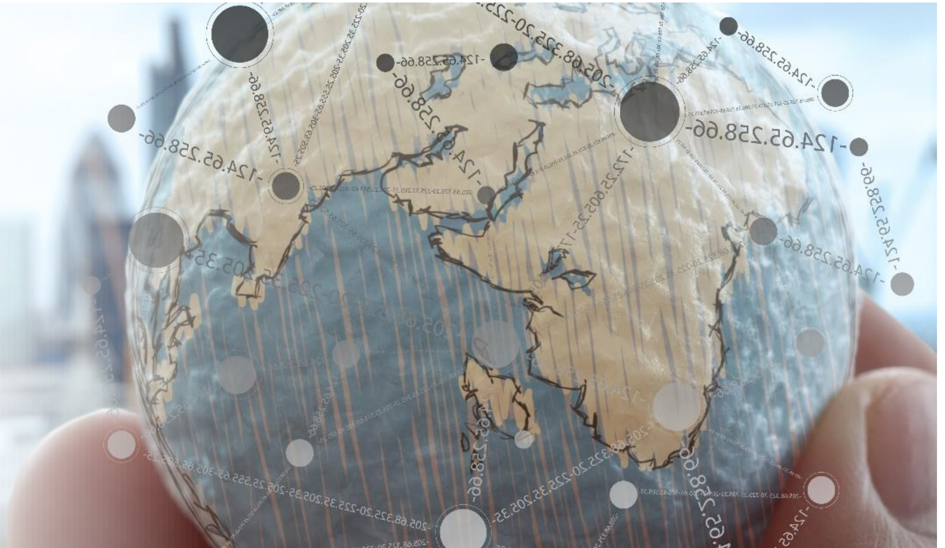
- Reliance in this regard was placed on ***Indo International Tobacco Ltd. Vs. Vivek Prasad, Additional Director, DGGI and Ors. [2022 (97) GSTR 414 (Del.)]***.

Observations and ruling of the High Court

- The power of Inspection, Search, Seizure and Arrest, as provided under Chapter XIV of the CGST Act, reflects that the power that is being exercised by the proper officer in terms of Sections 69, 70, 71 and 72 of the CGST Act are purely judicial in nature.
- As per Section 70(2) of the CGST Act, every inquiry shall be deemed to be judicial proceedings. Issuance of show cause notice is the point of commencement of any legal proceedings. Thus, once a proper officer has initiated any proceedings as per Section 6(2)(b) of the CGST Act, on a subject matter, no proceedings can be initiated by another officer on the same subject matter.
- The word 'subject matter' used in Section 6(2)(b) of the CGST Act would mean ***'the nature of proceedings'***. In the present case, it would mean the proceedings initiated for wrongful availment of ITC by fraudulent means. Thus, if the State Tax authority has already initiated proceedings by issuing notice under Section 74 of the CGST Act, for the same subject matter, the DGGI cannot be allowed to initiate proceedings in respect of the availment of ITC by fraudulent means for the subsequent period.

- The proper officer (HGST Department) who has initiated proceedings would be empowered to issue summons directing a person to give evidence and produce documents. While the other tax statutes provide for the transfer of cases from one officer to another, the scheme of the CGST Act restricts the same. Consequently, neither authority has the power to transfer the case from its jurisdiction to another nor any other authority can direct the transfer of an investigation/ proceeding from one officer to another as per Section 6(2)(b) of the CGST Act.
- However, in the present case, the HGST Department has issued notice to the Taxpayer and initiated proceedings for the period of FY 2017-18, 2018-19 and 2019-20, whereafter the order has been passed by DGGI MZU to conduct an investigation for the subsequent period.
- The CGST Act empowers both the State Tax and the Central Tax authorities with equal powers. Once these proceedings are held to be in the nature of judicial proceedings, as a corollary, these judicial proceedings cannot be transferred by administrative actions. Merely because DGGI has information relating to similar fraudulent availment of ITC by other firms who may be related to the firm against which the proceedings have been initiated under Section 74 of the CGST Act by the State authority itself, it would not be a sufficient ground to presume that the State GST authority would not be able to conduct the proceedings or examine the culpability of the said firm.
- If there is another firm which has also been found to have availed fraudulent ITC, the Central Tax authorities are not precluded from taking action against that firm. Thus, independent action against some other firm would not impede the proceedings already initiated by the State Tax authorities against the Taxpayer. However, the State Tax authority could not have been asked to transfer the case already pending before it relating to the availment of wrongful ITC under Section 74(1) of the CGST Act against the Taxpayer.
- When an inquiry is conducted by a State Tax authority and the investigation is required to be done by the Central Tax authority, the Central Tax authority would exercise the said power for the purpose of investigation. However, it would not mean that the proceedings being conducted by the State Tax authority would be transferred to them. They would only act as the investigating officer and their report relating to their investigation at PAN-India level will have to be submitted to the State Tax authority who has initiated the proceedings. There is no reason to believe that the proceedings in any manner would be hampered or would suffer as against the Taxpayer against which proceedings have been initiated under Section 74 of the CGST Act.

TRANSFER PRICING



Hon'ble Tax Tribunal, Ahmedabad: Observes That A Two-fold Approach Is Required To Ascertain ALP For Interest On Loans Advanced To Associated Enterprises. In The First Scenario, Upholds TP Adjustment Pertaining To Interest On A Loan Advanced To AE Which Was Obtained From Banks And In The Second Scenario, Restores The Issue Back To AO For Re-adjudication For Interest On A Loan Advanced From Own Funds

The taxpayer is engaged in the business of manufacturing pharmaceutical products. For Assessment Year (AY) 2010-11, a Transfer Pricing (TP) adjustment was proposed by the Transfer Pricing Officer (TPO) in case of interest on a loan advanced by the taxpayer to its associated enterprise (AE).

The taxpayer had obtained short-term loans amounting to INR 45 crores and INR 10 crores from two banks, at the interest rate of 11.50% and 9.50% respectively. Subsequently, this loan amount was provided by the taxpayer to its AE as short-term financial assistance during the year under consideration. The taxpayer, in lieu of the financial assistance, charged interest from its AE at an average interest rate of 7.08%.

The TPO did not agree with the approach adopted by the taxpayer and opined that:

- The taxpayer had not recovered the full amount of interest from its AE;
- The TPO computed the differential interest amount for making an adjustment in case of recovery of interest from the AE; and
- The TPO also made an adjustment in respect of loans advanced by the taxpayer out of its own funds.

The taxpayer preferred an appeal before the Commissioner of Income Tax (Appeals) CIT(A); however, the CIT(A) partly confirmed the additions made by the TPO.

Aggrieved, the taxpayer filed an appeal before the Income-tax Appellate Tribunal (Hon'ble Tax Tribunal).

The Hon'ble Tax Tribunal observed that:

Aggrieved, the taxpayer filed an appeal before the Income-tax Appellate Tribunal (Hon'ble Tax Tribunal).

The Hon'ble Tax Tribunal observed that:

- The CUP method is the most appropriate method to ascertain the arm's length price (ALP) of the international transaction of interest received on a loan. This will be applicable in the situation where the loan is advanced to AE of loans taken from banks. However, in a case where the loan is advanced to AE out of the taxpayer's own fund, this principle will not apply.
- Two-fold approach needs to be considered:
  - Where the loan is advanced to AE by obtaining a loan from the banks, whether the interest paid by the taxpayer to the banks was recovered from the AE.

    The interest on a loan advanced was worked out by the taxpayer based on the actual lending period for which the loan was advanced. However, the TPO had computed the interest for the entire period of 180 days for the determination of ALP. The Hon'ble Tax Tribunal observed that the interest from the AE can be charged only for the period for which the amount was actually advanced.

- Where the loan is advanced to AE out of its own funds, whether the interest recovered was in accordance with the rate of interest prevailing in the country of residence of the AE.

  The CIT(A) had not adjudicated the adjustment of interest from the loan advanced by the taxpayer from its own funds. The Hon'ble Tax Tribunal set aside the matter to the file of the Assessing Officer (AO) for re-adjudication of this adjustment.

Accordingly, the Hon'ble Tax Tribunal deleted the adjustment towards interest on loans advanced by the taxpayer from the third-party banks to its AE and remanded the matter back to the AO for the interest on loans advanced by the taxpayer by using their own funds.

Citation: Cadila Pharmaceuticals Ltd [TS-265-ITAT-2024(Ahd)-TP]

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CONTACT US

For any content related queries, you may please write to the service line experts at taxadvisory@bdo.in

For any other queries or feedback, kindly write to us at marketing@bdo.in

BDO IN INDIA OFFICES

Ahmedabad
Westgate Business Bay, Floor 6
Office No 601, Block A, Makarba
Ahmedabad, Gujarat 380051, INDIA

Bengaluru - Office 1
Prestige Nebula, 3rd Floor,
Infantry Road,
Bengaluru 560001, INDIA

Bengaluru - Office 2
SV Tower, No. 27, Floor 4
80 Feet Road, 6th Block, Koramangala
Bengaluru 560095, INDIA

Chandigarh
Plot no. 55, Floor 5,
Industrial & Business Park,
Phase 1, Chandigarh 160002, INDIA

Chennai
No. 443 & 445, Floor 5, Main Building
Guna Complex, Mount Road, Teynampet
Chennai 600018, INDIA

Coimbatore
Pacom Square, Floor 3, 104/1, Sakthi
Main Road, Bharathi Nagar, Ganapathy
Coimbatore, Tamil Nadu – 641006

Delhi NCR - Office 1
The Palm Springs Plaza
Office No. 1501-10, Sector-54,
Golf Course Road, Gurugram 122001, INDIA

Delhi NCR - Office 2
Windsor IT Park, Plot No: A-1
Floor 2, Tower-B, Sector-125
Noida 201301, INDIA

Goa
701, Kamat Towers
9, EDC Complex, Patto Plaza
Panaji, Goa 403001, INDIA

Hyderabad
1101/B, Manjeera Trinity Corporate
JNTU-Hitech City Road, Kukatpally
Hyderabad 500072, INDIA

Kochi
XL/215 A, Krishna Kripa
Layam Road, Ernakulam
Kochi 682011, INDIA

Kolkata
Floor 4, Duckback House
41, Shakespeare Sarani
Kolkata 700017, INDIA

Mumbai - Office 1
The Ruby, Level 9, North West Wing
Senapati Bapat Marg, Dadar (W)
Mumbai 400028, INDIA

Mumbai - Office 2
601, Floor 6, Raheja Titanium, Western
Express Highway, Geetanjali, Railway
Colony, Ram Nagar, Goregaon (E),
Mumbai 400063, INDIA

Mumbai - Office 3
Floor 20, 2001 & 2002 - A Wing, 2001 F
Wing, Lotus Corporate Park, Western
Express Highway, Ram Mandir Fatak Road,
Goregaon (E) Mumbai 400063, INDIA

Mumbai - Office 4
The Ruby, Level 9, South East Wing
Senapati Bapat Marg, Dadar (W)
Mumbai 400028, INDIA

Pune - Office 1
Floor 6, Building No. 1
Cerebrum IT Park, Kalyani Nagar
Pune 411014, INDIA

Pune - Office 2
Floor 2 & 4, Mantri Sterling, Deep Bunglow,
Chowk, Model Colony, Shivaji Nagar
Pune 411016, INDIA

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