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HEAVEN BE OUR GUIDE

Estd. 1926

92nd Year

ज्ञानं परमं बलम्

A Monthly Journal of
The Chamber of Tax Consultants

THE CHAMBER'S JOURNAL

Vol. VI | No. 10 July 2018

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

Infrastructure Trust

Real Estate Trust

BUSINESS TRUSTS

Accounting Aspects

Concept and Regulatory

Investments Funds

Securitisation Trust

Venture Capital Funds

Other Contents

- Direct Taxes • Other Laws
- Best of the Rest • Indirect Taxes
- International Taxation • Corporate Laws
- The Chamber News

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Managing Council 2018-19

Seated from L to R: S/Shri K. Gopal (Past President), Kishor Vanjara (Past President), Vipul Choksi (Vice President,) Hinesh Doshi (President), Ajay Singh (Imm. Past President), Mahendra Sanghvi, Manoj Shah, Hitesh R. Shah, Paras K. Savla (Past Presidents)

Standing from L to R: Ms. Nishtha Pandya, S/Shri Paras S. Savla, Bhavesh Joshi, Bhadresh Doshi, Ketan Vajani, Devendra Jain, Anish Thacker, Parag Ved, Dinesh Tejwani, Naresh Sheth, Ashok Sharma, Rahul Hakani, Heneel Patel

President 2018-19

CA Hinesh Doshi,
President
addressing the members
at the 91st AGM

Office Bearers 2018-19

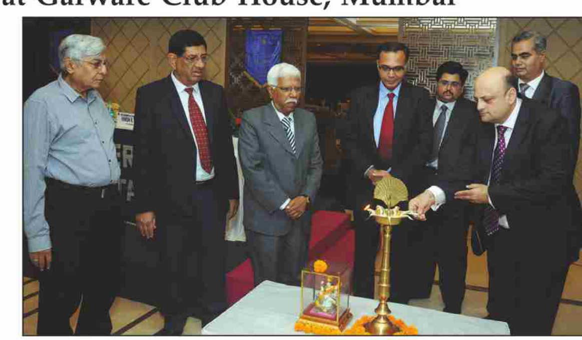
Seated from L to R:
S/Shri Vipul Choksi,
Vice-President,
Hinesh Doshi, President

Standing from L to R:
S/Shri Ketan Vajani,
Hon Treasurer,
Parag Ved, Anish Thacker,
Hon. Jt. Secretaries

91st AGM held on 4th July, 2018 at Garware Club House, Mumbai

Officer Bearers 2017-18

Seated from L to R: Shri Ketan Vajani, Ms. Nishtha Pandya, (Hon. Jt. Secretaries), Ajay R. Singh (President), Hinesh R. Doshi (Vice-President), Parag Ved (Hon. Treasurer).



Shri Hinesh Doshi, incoming President lighting the lamp to begin the 91st AGM. Seen from L to R: S/Shri Sharad Dalal, Vipin Batavia, Kishor Vanjara (Past Presidents) Ajay Singh (Imm. Past President), Ketan Vajani (Hon. Jt. Secretary), Parag Ved (Hon. Treasurer)

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Estd. 1926 — 92nd Year

The Chamber's Journal

***READER'S SUGGESTIONS AND VIEWS**: We invite the suggestions and views from readers for improvement of The Chamber's Journal. Kindly send your suggestions on office@ctconline.org.*

MEMBERSHIP FEES & JOURNAL SUBSCRIPTION FOR THE F.Y. 2017-18

Sr. No.	Membership Type		Fees	GST 18%	Total
1.	Life Membership (W.e.f. 1-7-2017)	₹	12000	2160	14160
2.	Journal Subscription (Life Members)	₹	1200	0	1200
					₹ 15360
3.	Admission Fees – Ordinary Members	₹	500	90	590
4.	Ordinary Membership Fees	₹	2200	396	2596
					₹ 3186
5.	Admission Fees – Associate Members	₹	1000	180	1180
6.	Associate Membership Fees	₹	5000	900	5900
					₹ 7080
7.	Journal Subscription (Non Members)	₹	2100	0	₹ 2100
8.	Student Membership Fees	₹	250	45	₹ 295
9.	Journal Subscription	₹	700	0	₹ 700

Editorial

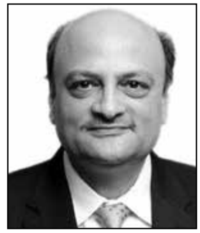
I congratulate Mr. Ajay Singh for successfully completing his term as President of the Chamber of Tax Consultants. He and his team deserve heartiest congratulations for raising the bar of performance of the Chamber of Tax Consultants in various fields. At the same time I wish all the best to Mr. Hinesh Doshi for taking over as President of Chamber of Tax Consultants for the year 2018-19. I know him as a go-getter and no-nonsense leader. My wish is these leaders are going to generate several more leaders who are going to work for the Chamber of Tax Consultants. With this, I wish all the best to Hinesh and his team.

As per the Black's Dictionary, the word "Trust" means 'a fiduciary relationship regarding property and charging the person with title to the property with equitable duties to deal with it for another's benefit; the confidence placed in a Trust, together with the Trustees obligations towards the property and the beneficiary is trust. To put it differently, the right, enforceable solely in equity, to the beneficiaries enjoyment of property to which another person holds the legal title; a property interest held by one person (the Trust) at the request of another (the settlor) for the benefit of third party (the beneficiary).' This wonderful legal concept was a major of tax planning a few years back. However, as the law settled, the tax planning through the Trusts was not in vogue. However, of late the Trusts have become a component of conducting business so that continuity is maintained and control is not diluted. There are several other advantages which prompted the Journal Committee to work on a special story dedicated to 'Business Trusts'. In this issue's special story, we are bringing out the same on business trusts. I thank Anish Thacker and Partha Tambdey for helping us in bringing out this issue.

I can't part with the editorial before referring to the great sufi Mr. Vilayat Khan's views on Trusts and Gifts. This is nothing concerning law. He says "if we make a gift of ourselves out of love, we become vulnerable. Yet, somehow, just like the child who continues to trust no matter how many times he is rejected or rebuffed, the goal is to go on trusting in life itself. The miracle is that then a foundation of trust begins to build up; as people value the trust we give to them, they begin to feel safe with us."

I thank all the professionals for taking out time for contributing to the Chamber's Journal out of their busy schedule.

K. GOPAL
Editor



From the President

My Dear Members,

यथा चतुर्भिः कनकं परीक्ष्यते ननकर्भणछेदनतापताडनः ।
तथा चतुर्भिः पुरुषः परीक्ष्यते श्रुतेन शीरेन कुरेन कर्भणा।।

...which means - Just as the purity of gold is tested by four means, namely - rubbing, cutting, burning and beating so also man is tested by four means, namely - learning, conduct, pedigree and action

I am humbled by the onerous responsibility before me as the President of the Chamber in its 92nd year (2018-19), grateful for the trust you all have bestowed on me, mindful of the path laid by my predecessors. I sincerely thank Mr. Ajay Singh, the outgoing president, for his relentless service to the Chamber, as well as the generosity and cooperation all the Office Bearers and Managing Council members have shown throughout my journey with the Chamber. Ajay has immensely and thoroughly enjoyed his Presidential term till the last day with a broad smile and has worked till last day with consistent and contagious enthusiasm, zeal and energy.

"When people are financially invested, they want a return. When people are emotionally invested, they want to contribute." – ***Simon Sinek, Author & Leadership Guru***

It is this emotional investment that has and always will hold us strong for the forthcoming year and many more years to come! We are unified by a noble purpose of serving to the profession and to give back to the society.

As we are moving towards the centennial mark, we glance back to see that the Chamber has had significant and lasting impact on fields spanning across various horizons with its cornerstone ingrained in matters of professional relevance. Over the years, the Chamber has become one of the influential professional institutions in the country. It has perfect blend of membership from various professionals including Chartered Accountants, Lawyers, Cost Accountants, Company Secretaries, Tax Practitioners and Students.

Journey to Presidency: From being just a member of the Chamber in 2007 to becoming Chairman of prestigious International Taxation Committee in 2010 for 3 years to being elected as Office Bearer in 2013 and now as President of "The Chamber of Tax Consultants" would not have been possible without the constant guidance and support of my fellow colleagues at Chamber and of course loving sacrifice of my parents and family. The climb to each higher step of this ladder has been propelled by the drive to contribute, the passion to learn, serve and to connect.

I would like to recognise my dear friend Bhavesh Vora who introduced me to the Chamber in 2007. I am also indebted to Sujal Shah, who first inducted me in Managing Council and appointed me as Chairman of International Taxation Committee. My formative days started when my *alma mater* firm, Khimji Kunverji & Co., motivated me to become Convenor of Chembur Study Circle. My bosses Shivji bhai, Kamlesh bhai and Nilesh bhai Vikamsey ingrained in me leadership skills and selfless service to society. My training at S. V. Ghatalia & Co. (now part of EY) post CA qualification also sharpened my technical skills and service acumen.

THE PILLARS OF THE CHAMBER

1. Programmes: ***"Education is a life long Journey; whose destination expands manifold".***

Each of us bear a responsibility to carry this torch of knowledge to as many as possible. The Chamber has significantly contributed in disseminating knowledge and enhancing awareness. As the Chamber symbolises excellence and societal impact, we should make every effort to sustain and enhance the quality and impact in what we are doing and what we further intend.

2. Membership

The power of inclusiveness motivates us to enthuse more and more professionals into the Chamber's family. The fusion of brilliance of seasoned members with freshness of the younger members of the fraternity is key to thrust our Chamber into newer horizons with 'excellence & innovation' being its fundamental base. After consolidation for several years, we have pierced the technical barrier of 4,000 members and now we will see bull phase for the Chamber with membership target of 5,000 for 2018-19 and 10,000 for 2022-23.

3. Visibility

The Chamber has created and harnessed a vibrant social media presence which is today's medium of creating multi-fold touchpoints. This move needs to be leveraged by actively optimising and widening its reach all the way to the common man. Shift to the Digital era including: Interactive Website, Webinars, E-communication and E-publications. Creating a highly visible Social Media presence by way of Brand Building, Brand Recall & Media coverage.

4. Team and Vision

The time to sow the seeds of materialising our vision – both short term (2018-19) and a long term "Vision-2023" into reality has already begun. The 5 Office bearers are like 5 Pandavas, 26 managing council members and 300 plus core committee members, each equipped with a different skillset which, when integrated with each other form a powerful and unbeatable Bahubali team. This strong team is composed of team members who are all contributing whole heartedly with enthusiasm & contentment.

"A stone is broken by the last stroke of hammer. This does not mean that the first stroke is ineffective. Success is the result of continuous and persistent effort".

NEW TAGLINE AND LOGO

We unveil our new Tagline and Logo for current year:

"Gateway to professional growth"

Learning is imbibed in the core culture, here at the Chamber. Not only in the regular programmes bearing technical enrichment, the Chamber is adorned with being a coach of intangibles; in terms of team-work, micro and macro management and the power of collaborative thinking. The Chamber plans to become Gateway to nurture future growth by imparting training, education and skill development.

The Government of India has recently crowned the Services Sector of India with a symbol- "the Peacock" in the Global Exhibition of Services. In line with this important initiative, we have decided to design our logo for the current year aligned to this symbol.

SPREADING OUR WINGS

Extending Geographical reach apart from the existing locations such as Aurangabad, Jamnagar, Solapur, Vapi, Nashik, Indore, Raipur & Goa where seminars and conferences are already conducted. A study group at Pune had recently been formed. We would want these and many more locations transform into the CTC Chapters & Study Groups with active participation and recognition by members & other professional institutions. I have identified Bangalore, Nashik, Hyderabad for forming Study Group / Chapter during this year.

REPRESENTATIONS

Our representations on various policy matters in order to mitigate potential grievances and pose a voice to issues faced by many have proved to benefit the public at large. We intend to add more Representations for various issues, especially pertaining to FEMA, GST, Insolvency Code, Companies Act, SEBI, Stock Exchanges, PMLA, Benami Law and we shall join hands with sister organisations for effective representation and will continue to collaborate with authorities at appropriate levels and bring about tangible change/benefits.

CURRENT STATE OF ECONOMY

We need to be seriously concerned about rising oil prices, spiralling inflation, firming Bond yields, widening Current Account Deficit (CAD), Trade and Fiscal deficit, and Geo-political risks due to the ongoing trade wars are a few areas of concern which will have a spillover effect on our economy.

CHAMBER NEWS

We have successfully conducted marquee programmes in the month of June including 12th Residential Conference on International Taxation held at Indore from 21st to 24th June, 2018 attended by highest number of 216 delegates till date, half day workshop on Income Tax Return filing provisions and Workshop on Benami Transactions Act, 2016.

We have planned many events in July and August namely half day seminar on Issues in Tax Return filing, Full day programme on Company Audit and Tax Audit, Two days course on IND AS Implementation, 4th CTC Football Cup match, Public lecture meeting on GST – Pains and Gains, Two Webinars on Managing peak period return filing, Round Table Meeting on Cross Border Insolvency, and many more. Please read our CTC Newsletter for complete details.

***"You don't build Institutions, you build people and then….. People build the Institution"* – I offer a heartfelt thanks to the Staff of CTC for being part of this wonderful family.**

The special story for month of July is on "Business Trust" and I thank all the Authors for sparing their valuable time and for their contribution to the Chambers Journal for this month.

It is said "Raindrops may be small in size and shape ………but, their continuous fall makes a river overflow. Similarly, we believe that our small and consistent efforts make substantial changes in a professional's life". With a drive to innovate, we are conceptualising some with fresh initiatives which I urge each one of you to be a part of. I must say, and most of you will agree that the programmes conducted by the Chamber have acted as the wind beneath our wings, aiding us to reach and surpass higher skies.

Let us together **Advance, Build and Connect** – Advance to greater horizons, Build professionals to leaders & connect to allure stronger bonds.

I look forward for a vibrant and eventful year ahead !

Pranam

HINESH R. DOSHI
President

CA Subramaniam Krishnan & CA Mamta Shroff

Alternative Investment Funds and Venture Capital Funds – An Overview

1. Background

The Securities and Exchange Board of India (SEBI) introduced the SEBI (Alternative Investment Funds) Regulations, 2012 (hereinafter, referred to as the 'AIF Regulations') in May 2012. With the introduction of the AIF Regulations, the erstwhile SEBI (Venture Capital Funds) Regulations, 1996 (hereinafter referred to as the 'VCF Regulations') were repealed and the funds registered thereunder were grandfathered, however, such venture capital funds were not permitted to launch a new scheme and the then existing funds/ schemes could not increase the targeted corpus. A venture capital fund could seek re-registration under the AIF Regulations subject to approval of two-thirds of their investors by value of their investment.

Under the AIF Regulations, funds are mandatorily required to obtain registration and comply with the investment and other conditions. The definition provided for an AIF in the AIF Regulations is wide enough to cover within its ambit all forms of vehicles set-up in India, subject to certain exceptions, for pooling of funds from investors (where Indian or foreign). The exceptions include:

i. Employee welfare trusts, ESOP trusts, family trusts or gratuity trusts set up for the benefit of employees;

ii. Other special purpose vehicles not established by fund managers, including securitisation trusts, regulated under a specific regulatory framework;

iii. Holding companies;

iv. Funds managed by securitisation company or reconstruction company which is registered with the Reserve Bank of India under Section 3 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002; and

v. Any such pool of funds which is directly regulated by any other regulator in India.

2. Categories of AIFs

AIF Regulations have outlined different categories of funds with the intent to distinguish the investment conditions, restrictions, concessions available to each of them. All AIFs are required to mandatorily seek registration in one of the categories mentioned in the table below. Further, in case of Category I AIF, they are required to register under one of the sub-categories.

The categories of AIFs based on their investment objectives are tabulated below:

Category I AIF	Category II AIF	Category III AIF
• Funds that invest in start-up or early-stage ventures or social ventures or Small and Medium Enterprises (SMEs) or infrastructure or other sectors or areas that the government or regulators consider as socially or economically desirable. • Category I have the following sub-categories: o Venture capital funds including angel funds; o SME funds; o Social venture funds; o Infrastructure funds; and o Such other funds as may be prescribed by SEBI from time-to-time (none prescribed to date)	• Funds that cannot be categorised as Category I AIFs or Category III AIFs and that do not undertake leverage or borrowing other than to meet the permitted daily operational requirement. • AIFs such as private equity funds and debt funds qualify under this category.	• Funds that employ diverse or complex trading strategies and may employ leverage including through investment in listed or unlisted derivatives. • AIFs such as hedge funds, funds which trade to make short term returns, open-ended funds qualify under this category.

3. Registration of the AIFs under the AIF Regulations

An application for grant of certificate has to be made for any of the categories as specified above in Form A shall be accompanied by a non-refundable application fee of INR 100,000.

For the purpose of the grant of certificate to an applicant, SEBI considers, *inter alia*, the following conditions for eligibility —

a. Constitution of the AIF vehicle permits it to carry on the activity of an AIF;

b. Depending on the legal constitution of the AIF (i.e., trust or a limited liability partnership or a company); the constitution documents have been filed under the applicable laws and permit the entity to carry on the activities of an Alternative Investment Fund;

c. The applicant, sponsor and manager are fit and proper persons based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008;

d. The key investment team of the manager of the AIF has adequate experience, with at least one key personnel having not less than five years' experience in advising or managing pools of capital or in fund or asset or wealth or portfolio management or in the business of buying, selling and dealing of securities or other financial assets and has relevant professional qualification;

e. The Manager or Sponsor has the necessary infrastructure and manpower to effectively discharge its activities;

f. The applicant has clearly described at the time of registration the investment objective, the targetted investors, proposed corpus, investment style or strategy and proposed tenure of the fund or scheme.

For the purpose of application with SEBI, along with Form A, the applicant needs to file the constitution documents, a private placement memorandum in relation to the first scheme along with certain declarations as specified in the AIF Regulations.

Once SEBI approves the application, the applicant is directed to pay the specified registration fee as follows:

Category of AIF	Registration fee (INR)
Category I AIF other than angel funds	500,000
Angel funds	200,000
Category II AIFs	1,000,000
Category III AIFs	1,500,000

On payment of the registration fee, SEBI shall issue a final registration certificate to the applicant.

Where a draft trust deed/ partnership agreement is submitted by the applicant at the time of application, SEBI may grant an in-principle approval to the applicant provided that the application will need to finalise the trust deed/ partnership agreement within 6 months from the date of grant of in-principle approval and upon compliance with the same, SEBI will grant a certificate of registration. An AIF that has been granted in-principle approval may accept commitments from investors but shall not accept any monies till it is granted registration.

3.1 Conditions of certificate of registration

The certificate of registration granted by SEBI is subject to the provisions of the AIF Regulations and the AIF is required to inform SEBI in writing, if any information or particulars previously submitted to SEBI are found to be false or misleading in any material particular or if there is any material change in the information already submitted.

An AIF which has been granted registration under a particular category cannot change its category subsequent to registration except with SEBI approval.

3.2 Introduction of schemes

An AIF registered with SEBI under the AIF Regulations may launch schemes subject to filing of placement memorandum with SEBI.

Such placement memorandum shall be filed with SEBI at least 30 days prior to launch of scheme along with a fee of INR 100,000.

SEBI may communicate its comments, if any, to the applicant prior to launch of the scheme and the applicant shall incorporate the comments in placement memorandum prior to launch of scheme.

4. Investment in an AIF

As per Regulation 10 of the AIF Regulations, investment in any category of AIF is subject to the following conditions[1]:

i. An AIF may raise funds from any investor (resident or non-resident) by way of issue of units;

ii. Each scheme of the AIF shall have corpus of at least INR 200 million;

iii. AIF shall not accept from an investor, an investment of value less than INR 10 million provided that in case of investors who are employees or directors of the AIF or employees or directors of the Manager, the minimum value of investment shall be INR 2.5 million;

iv. In case of a Category I/ Category II AIF, the manager or sponsor shall have a continuing interest of not less than 2.5%

1 For conditions in relation to Angel funds, refer subsequent paragraphs

of corpus or INR 50 million, whichever is lower, in each scheme of the AIF and such interest shall not be through the waiver of management fees. In case of Category III AIF, the continuing interest shall be not less than 5% of the corpus or INR 100 million, whichever is lower in each scheme.

v. No scheme of the AIF shall have more than 1,000 investors.

5. Investment conditions applicable to AIFs

Regulation 15 of the AIF Regulations prescribe certain general investments conditions that needs to be complied with by all the categories of AIFs while making investments. Further, regulations 16, 17 and 18 prescribe the conditions to be followed by each of the specific category of the AIFs for making investments. Key conditions include -

i. AIF may invest in securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and the SEBI from time-to-time (refer detailed discussion below).

ii. Category I and II AIF to invest not more than 25% of the investible funds[2] in one investee company[3]. Category III AIF to invest not more than 10% of the investible funds in one investee company.

iii. AIF shall not invest in associates[4] except with the approval of 75% of investors by value of their investment in the AIF.

iv. Un-invested portion of the investible funds may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury bills, CBLOs, Commercial Papers, Certificates of Deposits, etc. till deployment of funds as per the investment objective.

v. Each of the sub-category under Category I AIF are required to invest in the specific sector relevant to that sub-category.

vi. Category II AIFs are permitted to invest primarily in unlisted investee companies, however, there is no requirement of a specific sector being targeted.

vii. Category III AIFs are permitted to invest in securities of listed or unlisted investee companies or derivatives or complex or structured products.

6. Angel Funds

With the objective of encouraging the start-up ecosystem in India, SEBI amended the AIF Regulations in September 2013 to bring 'Angel Funds' under the definition of VCFs.

Angel funds has been defined to mean a sub-category of VCFs under Category-I AIF that raises funds from angel investors and invests in accordance with the AIF Regulations.

Angel investor means any person who invests in angel funds and fulfils one of the following conditions:

- individual investor who has net tangible assets of at least INR 20 million excluding value of his principal residence and who has early stage investment experience[5] or has experience as serial entrepreneur[6] or is a senior management professional with at least 10 years of experience;

2 Investible funds means corpus of the AIF net of estimated expenditure for administration and management of the fund

3 Investee company means any company, special purpose vehicle or limited liability partnership or body corporate or real estate investment trust or infrastructure investment trust in which an AIF makes an investment

4 Associate means a company or a limited liability partnership or a body corporate in which a director or trustee or partner or sponsor or manager of the AIF or a director or partner of the manager or sponsor holds, either individually or collectively, more than 15% of its paid-up equity share capital or partnership interest, as the case may be

5 Means prior experience in investing in start-up or emerging or early-stage ventures

6 Means a person who has promoted or co-promoted more than one start-up venture

- a body corporate with a net worth of at least INR 100 million; or
- an AIF registered under the AIF Regulations or a VCF registered under the VCF Regulations

No scheme of the Angel fund shall have more than 200 angel investors. An Angel fund may launch schemes subject to filing of a term sheet with SEBI, containing material information regarding the scheme, in the format and time period as may be specified by SEBI.

6.1 Investment in Angel funds

- Angel funds shall only raise funds by way of issue of units to angel investors.
- An angel fund should have a corpus of at least INR 50 million and minimum investment by an angel investor into such a fund shall be INR 2.5 million (may be accepted upto a maximum of 5 years).

6.2 Investment by Angel funds

Angel funds will only be allowed to invest in VCUs which complies with the criteria regarding the age of the VCU/ start-up issued by the Department of Industrial Policy and Promotion or such other policy made in this regard which may be in force and has a turnover of less than INR 250 million. Investments are barred in entities which are promoted, sponsored or related to an industrial group[7] whose group turnover[8] is in excess of INR 3000 million or are companies with family connection with any of the angel investors who are investing in the company.

The investment should be a minimum of INR 2.5 million and a maximum of INR 100 million. It would have a lock-in period of one year.

Angel funds shall not invest in associates. Further, Angel funds shall not invest more than 25% of the total investments under all its schemes in one VCU provided that the compliance of this sub-regulation shall be ensured at the end of its tenure.

An angel fund may also invest in the securities of companies incorporated outside India subject to such conditions or guidelines that may be stipulated or issued by the Reserve Bank of India and the Board from time to time

Angel funds however, are prohibited from listing their units on any stock exchange.

6.3 Obligations of sponsor/ manager of Angel funds

The manager or sponsor shall have a continuing interest in the angel fund of not less than 2.5% of the corpus or INR 5 million, whichever is less, and such interest shall not be through the waiver of management fees.

The manager of the Angel fund shall obtain an undertaking from every angel investor proposing to make investment in a venture capital undertaking, confirming his approval for such an investment, prior to making such an investment.

7. Leverage by AIFs

The following table summarises the conditions related to borrowings/ leverage by different categories of AIFs:

Category I/ Category II AIFs	• Category I/ Category II AIFs shall not borrow funds directly or indirectly or engage in leverage except for meeting temporary funding requirements for more than thirty days, on not more than four occasions in a year and not more than 10% of its investible funds.

7 Industrial group shall include a group of body corporates with the same promoter(s)/promoter group, a parent company and its subsidiaries, a group of body corporates in which the same person/ group of persons exercise control, and a group of body corporates comprised of associates/subsidiaries/holding companies.

8 Group turnover shall mean combined total revenue of the industrial group

Category III AIFs	• Category III AIFs can engage in leverage or borrow subject to consent from investors in the fund and subject to a maximum limit as may be specified by SEBI[9]. • All Category III AIFs which undertake leverage, whether through investment in derivatives or by borrowing or by any other means shall comply with the following prudential requirements: i. For the purpose of arriving at leverage undertaken by an AIF, leverage shall be calculated as the ratio of the exposure to the Net Asset Value (NAV) of the AIF. ii. Leverage shall be calculated as under: Leverage = $\frac{\text{Total exposure \{Longs+Shorts (after offsetting as permitted)\}}}{\text{NAV}}$ iii. The leverage of a Category III AIF shall not exceed 2 times of the NAV of the fund. i.e. If an AIF's NAV is ₹ 100 crore, its exposure (Longs+shorts) after offsetting positions as permitted shall not exceed ₹ 200 crore. iv. NAV is the sum value of all securities adjusted for mark to market gains/ losses (including cash and cash equivalents) and excluding any borrowed funds.

8. Foreign investments in AIFs

The Reserve Bank of India (RBI) notified regulatory policy[10] enabling foreign investments in AIFs under the automatic route in 2015.

A person resident outside India (other than an individual who is a citizen or an entity which is registered/ incorporated in Pakistan or Bangladesh), including a Foreign Portfolio Investor or a Non-resident Indian is permitted to acquire, purchase, hold, sell or transfer units of an AIF subject to the prescribed exchange control regulations.

A person resident outside India who has acquired or purchased units in accordance with these regulations may sell or transfer in any manner or redeem the units as per regulations framed by SEBI or directions issued by RBI.

Downstream investment by AIFs (i.e., investment by AIFs in portfolio entities) is regarded as foreign investment if the AIF's sponsor or the manager (i) is not owned and not controlled by resident Indian citizens or (ii) is owned or controlled by persons resident outside India.

The criteria of 'owned and controlled' for sponsors or the manager is to be determined as under:

- Sponsors/ Managers organised as companies: A company is considered to be 'owned' by resident Indian citizens if more than 50% of its capital is beneficially held by resident Indian citizens and/ or Indian companies which are ultimately owned and controlled by resident Indian citizens. A company is considered to be 'controlled' by resident Indian citizens if the right to appoint majority of directors or to control the management or policy decisions including by virtue of their shareholding or management rights or shareholders agreement or voting agreement is held by resident Indian citizens and/ or Indian companies which are ultimately owned and controlled by resident Indian citizens.

- Sponsors/ Managers organised as Limited Liability Partnerships (LLP): An LLP will be considered as 'owned' by resident Indian citizen if more than 50% of the

9 CIR/IMD/DF/10/2013 dated July 29, 2013

10 Notification No. FEMA. 355/ 2015-RB dated November 16, 2015

investments in such an LLP are made by resident Indian citizens and/ or entities which are ultimately 'owned and controlled' by resident Indian citizens and such resident Indian citizens and entities have majority of the profit share in the LLP. An LLP is considered to be 'controlled' by resident Indian citizens where the right to appoint the majority of the designated partners, where such designated partners, with specific exclusion to other, have control over all the policies of the LLP.

- Sponsors/ Managers organised being individuals - Should be a resident Indian citizen.

Where the downstream investments of an AIF are considered as foreign investments, such investments shall have to adhere to the sectoral caps and conditions/ restrictions, if any, as applicable to the investee entity as per the extant FDI policy.

The rule for Category III AIFs is distinct and does not follow the criteria discussed above. Category III AIFs having foreign investments are permitted to make portfolio investments only in securities/ instruments in which an FPI is allowed to invest under the prescribed rules and regulations. This restriction would be attracted irrespective of the level of foreign investment in the Category III AIF. Accordingly, where a Category III AIF having investments from foreign investors proposes to invests in securities other than those permitted for FPIs, specific approval may be required from RBI to make such investments.

Also, an NRI or an Overseas Citizen of India (OCI), including a company, trust and a partnership firm incorporated outside India and owned and controlled by NRIs or OCIs are permitted to invest in AIFs on a non-repatriation basis. Such investment will be deemed to be domestic investment at par with the investment made by residents.

RBI has issued a circular[11] prescribing the form (Form InVi) for reporting foreign investments in an AIF. The form is a part of the Single Master Form.

9. Foreign investments by AIFs

AIFs are permitted to invest in securities of companies incorporated outside India subject to the guidelines as stipulated by the RBI and SEBI[12] from time to time. The RBI has permitted[13] an AIF, registered with SEBI, to invest overseas in terms of the prescribed circulars[14].

- AIFs may invest in equity and equity linked instruments of offshore VCUs[15] subject to an overall ceiling of USD 750 million for all AIFs and VCFs registered under the AIF Regulations and VCF Regulations respectively.
- Investment in offshore VCUs require prior approval. The AIF shall have 6 months from the SEBI approval date for making allocated investments in offshore VCUs. No separate permission is required from RBI.
- The total foreign investments should not exceed 25% of the investible funds of a scheme of the AIF.

10. Concluding Remarks

The regulatory framework for AIFs has evolved over a period of time. With the Government focussing on channelising the domestic savings and providing flexible regime for foreign investors to invest in India, the amendments in the AIF regulatory regime provides an impetus for the Indian fund managers to set-up domestic funds for investing in the identified Indian investment opportunities.

❍❑❍

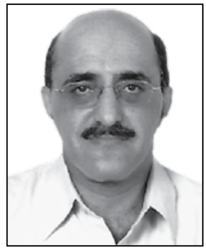
11 A.P. (DIR Series) Circular No. 30 dated 7 June 2018

12 CIR/IMD/DF/7/2015 dated October 1, 2015

13 A.P. (DIR Series) Circular No. 48 dated December 9, 2014.

14 A.P. (DIR Series) Circulars No. 49 and 50 dated April 30, 2007 and May 4, 2007 respectively.

15 Offshore VCUs have been defined to mean a foreign company whose shares are not listed on any of the recognised stock exchanges in India or overseas. Also, such offshore VCUs should have an Indian connection (eg. Company which has a front office overseas, while back operations are in India)



CA Zubin Billimoria

Alternative Investment Funds and Venture Capital Funds – Accounting Aspects

INTRODUCTION

Meaning of Alternative Investment Fund

An Alternative Investment Fund (AIF) means any fund which is established or incorporated in the form of a privately pooled investment vehicle which collects funds generally from *sophisticated investors*, whether Indian or foreign, for investing it in accordance with a defined investment policy for the benefit of its investors. The term *alternative* is vital as it shows the entities specified as AIFs are not like the traditional institutions – mutual funds, pension funds, insurance companies etc., for which there are existing regulations and guidelines whether issued by SEBI or other regulators like Insurance Regulatory and Development Authority (IRDA) and Pension Fund Regulatory Development authority (PFRDA).

With the identification of the benefits of venture capital investments for the growth of specific sectors, the Government of India started introducing various regulations targeted at different forms of investment funds in India, such as mutual funds, collective investment schemes, etc. However, caught in the confusion of many regulations, the Venture Capital Fund ("VCF") vehicle came to be used by many other funds such as private equity ("PE"), private investment in public equity, real estate, etc., thereby making it difficult to give targeted concessions to VCFs to promote start up or early stage companies. It is in this background that in 2012 SEBI introduced the **SEBI (Alternative Investment Funds) Regulations, 2012 ("the AIF Regulations")** to recognise AIFs, such as PEs and VCFs.

Types of AIFs

In terms of the AIF Regulations, AIFs shall seek registration in one of the categories mentioned hereunder:

- **Category I AIF** which invests in *start-up or early stage ventures or social ventures or SMEs or infrastructure or other sectors or areas which the Government or regulators consider as socially or economically desirable*. Accordingly, AIFs which seek registration under this category, would have to specify one of the following sub categories at the time of registration:

1. **Venture capital funds (Including Angel Funds)**
2. **SME Funds**
3. **Social Venture Funds**
4. **Infrastructure funds**

- **Category II AIF** which *does not fall in Category I as discussed above and Category III as discussed below*, and which does not undertake leverage or borrowing other than to meet day-to-day operational requirements and as permitted in these regulations.
- **Category III AIF** which employs *diverse or complex trading strategies and may employ leverage including through* ***investment in listed or unlisted derivatives.***

Category I and Category II AIFs shall be *close ended* and the tenure of fund or scheme shall be determined at the time of application subject to a minimum tenure of three years. *Category III AIFs* may be *open ended or close ended*. Extension of the tenure of the close ended AIF may be permitted up to two years subject to approval of two-thirds of the unit holders by value of their investment. In the absence of consent of unit holders, the AIF shall fully liquidate within one year following expiration of the fund tenure or extended tenure.

An AIF can be established or incorporated in the form of a trust or a company or a limited liability partnership or a body corporate. **Since most of the AIFs registered with SEBI are in the form of a trust, our discussion on the accounting aspects which follow would be keeping this aspect in mind due to space constraints.**

KEY REGULATORY CONSIDERATIONS

Whilst the scope of this article does not extend to examining the regulatory considerations, the following are some of the matters laid down in the AIF regulations and other related aspects which could have implications on the accounting considerations which are discussed subsequently.

Sponsor of the AIF

The term "sponsor" has been defined in the AIF Regulations as any person or persons who set up the AIF and includes promoter in case of a company and designated partner in case of a limited liability partnership.

Further, as per the AIF Regulations, a Sponsor shall have a *continuing interest* in the AIF of not less than *2.5% of the corpus or five crore rupees, whichever is lower*, in the form of *investment in the AIF* and such interest shall not be through the waiver of management fees. Further, in the case of *Category III AIF, the continuing interest* shall be not *less than 5% of the corpus or ten crore rupees, whichever is lower*. It may be noted that the above are the minimum limits for investment and there is no maximum limit. ***Accordingly, the level of investment together with the powers, rights and duties of the sponsor would need to be evaluated as to whether the sponsor exercises control or significant influence over the AIF under the Accounting Standards as applicable to the sponsor, thereby requiring consolidation or equity method of accounting.***

Appointment of Investment Managers

The activities of the AIF are handled by the **Investment Manager** who is appointed by the sponsor, whose main function is to ensure that the funds collected from the investors are invested as per the investment objectives of the scheme/fund for which he is paid *Management Fees/Performance Fees which could be at a fixed percentage of the assets managed/investments made and/or based on the performance.*

Placement Memorandum

The AIF Regulations provide that AIFs shall raise funds through private placement by issue of information memorandum or placement memorandum, by whatever name called.

The Private Placement Memorandum shall contain all material information about the AIF and the Manager, background of key investment team of the Manager, targeted investors, fees and all other expenses proposed to be charged, tenure of the AIF or the scheme, conditions or limits on redemption, investment strategy, risk management tools, rights attached to various categories of units, calculation of the NAV etc.

A proper study of the Placement Memorandum is necessary to frame the appropriate accounting policies and determine the correct manner for accounting of the various types of transactions.

Tenure of the AIF or the Schemes

The AIF Regulations contain certain provisions with regard to the tenure of the AIF or the Schemes under it, which are summarised hereunder:

- Category I and II AIFs or schemes launched by such funds shall have a minimum tenure of three years.
- Category III AIF may be open ended or close ended.
- Extension of the tenure of the close ended Alternative Investment Fund may be permitted up to two years subject to approval of two-thirds of the unit holders by value of their investment in the AIF.
- In the absence of consent of unit holders, the AIF shall fully liquidate within one year following expiration of the fund tenure or extended tenure.

Status of Existing Venture Capital Funds

Finally, the funds registered as **venture capital fund** under **Securities and Exchange Board of India (Venture Capital Funds) Regulations, 1996** shall continue to be regulated by these regulations till the existing fund or scheme managed by the fund is wound up and such funds shall not launch any new scheme after notification of these regulations. Accordingly, for the purposes of this Article, the terms Venture Capital Fund and AIF would be used interchangeably.

After having gained a preliminary understanding of AIFs, let us now proceed to gain a general understanding of the various accounting and related aspects pertaining thereto.

ACCOUNTING ASPECTS

As is the general practice, the accounting aspects of any industry or business are determined by the regulatory requirements and the framework which is laid down by the professional bodies like the Institute of Chartered Accountants of India (ICAI). Whilst this is true as far as general companies and certain other entities like banks, insurance companies and mutual funds are concerned, it does not strictly hold true for AIFs. This is due to the fact that the AIF Regulations do not lay any format for the preparation and presentation of financial statements nor deal with the peculiar and specific accounting policies and disclosure requirements keeping in mind the nature of the business undertaken by such entities.

Accordingly, guidance would need to be drawn from the **Preface to the Statements of Accounting Standards** issued by the ICAI, according to which, Accounting Standards are designed to apply to the general purpose financial statements and other financial reporting, which are subject to the attest function of the members of the ICAI. As per the Preface, Accounting Standards apply in respect of any enterprise, irrespective of its legal status, engaged in commercial, industrial or business activities, irrespective of whether it is profit oriented or it is established for charitable or religious purposes. Accounting Standards will not, however, apply to enterprises only carrying on the activities which are not of commercial, industrial or business nature, (e.g., an activity of collecting donations and giving them to flood affected people). Since the activities of AIFs are considered as commercial in nature, it is clear that the Accounting Standards issued by the ICAI would apply to them to the extent relevant and not in conflict with any regulatory requirements which are laid down.

Since a majority of the AIFs are in the form of Trusts, they would have to follow the General Accounting Standards notified by the ICAI. However, as discussed above, in very rare situations where the sponsor has higher level of investments which would enable it to exercise ***control or significant influence,*** *the accounts of the AIF would also need to be consolidated to comply with the requirements of the Companies Act, 2013 since the sponsor is a company registered under the said Act. Accordingly, if the sponsor is a Company to whom* ***IFRS converged Indian Accounting Standards (Ind AS) notified under the Companies (Indian Accounting Standards), Rules, 2015 apply,*** *it would be desirable if the AIF also follows these Standards rather than the normal Accounting Standards.*

Keeping the above in mind, the significant accounting aspects for AIFs can be broadly discussed under the following heads.

- **Format/Content of the Financial Statements**
- **Accounting for Contributions from Investors**
- **Investment Accounting**
- **Derivatives Accounting**
- **Determination of NAV**
- **Calculation and Accounting for Performance Management Fees**

Let us now proceed to dig a little deeper into each of the above aspects.

FORMAT FOR CONTENT OF THE FINANCIAL STATEMENTS

As discussed above, the AIF Regulations do not specify the format for the financial statements. However guidance can be drawn from the SEBI Regulations on Mutual Funds, which specify the format of the Financial Statements. Accordingly, based on a review of selected financial statements and keeping in mind the SEBI Mutual Fund Guidelines, and the business model of AIFs, an indicative format of the financial statements for them is given below:

BALANCE SHEET AS ON ________

Particulars	Note No.	Amount ₹
LIABILITIES:		
Contributors' Funds		
Unit Capital	2	
Units Pending Allotment		
Reserves and Surplus	2	
Current Liabilities		
Trade payables		
Other Current Liabilities	4	
TOTAL		
ASSETS:		
Investments	3	
Current Assets, Loans and Advances		
Cash and Cash Equivalents		
Interest Accrued on Investments		
Other Current Assets	4	
TOTAL		

Notes:

1. The details of each of the above items can be given by way of a separate schedule/ note, to the extent relevant and applicable.
2. The break-up of Unit Capital should be shown by class of units or based on the nature of rights attached thereon and further bifurcating the same by way of fresh allotments and redemptions depending upon whether the scheme

is open ended or close ended and the duration thereof. A further discussion on the accounting and disclosure aspects follows.

3. The nature and type of investments by instrument and entity, further bifurcated between current and non-current showing separately the cost and the market/ fair value either individually or in the aggregate needs to be disclosed. A further discussion on the accounting and disclosure aspects follows.

4. These would generally include mark-to-market losses/gains in respect of derivative instruments, wherever applicable. A further discussion on the accounting and disclosure aspects follows.

INCOME AND EXPENDITURE ACCOUNT FOR THE YEAR ENDED ________

Particulars	Note No.	Amount ₹
INCOME		
Investment Income		
Other Income		
Unrealised Gain on Investments	2	
TOTAL INCOME		
EXPENDITURE		
Operating and Administrative Expenses	3	
Unrealised Loss on Sale of Investments	2	
TOTAL EXPENDITURE		
SURPLUS/(DEFICIT) CARRIED OVER TO BS		

Notes:

1. The details of each of the above items can be given by way of a separate schedule/ note, to the extent relevant and applicable.

2. This would depending upon the accounting policy adopted for recognition and measurement of investments which is discussed subsequently.

3. Apart from the normal expenses, the following are some of the specific expenses which are applicable to AIFs:

- Investment Management Fees
- Performance Management Fees
- Trusteeship Fees
- Registrars' Fees
- Custodians Fees
- Fund Accounting Fees

These are generally based on a percentage of the assets under management and are generally contractually agreed upfront and would need to be *accrued according to the frequency with which the NAV needs to be calculated, which is discussed subsequently.* **However, there are specific guidelines/ considerations which govern the accounting for Performance Management Fees, which are discussed subsequently.**

Whilst the above is the commonly used format, certain AIFs adopt the format as well as the principles for disclosure laid down in **Schedule III of the Companies Act, 2013** to the extent applicable and relevant. *Accordingly, it would be desirable if SEBI lays down the form and content of the Financial Statements and other minimum disclosure requirements as is the case with Mutual Funds and other entities so as to ensure uniformity and better comparability.*

*Finally, care needs to be taken that specific disclosures under the applicable framework of the Accounting Standards as well as any other statute are given. Examples of these include **Related Party transactions, disclosures under the Micro, Small and Medium Enterprises Development Act, 2006 etc.***

ACCOUNTING FOR CONTRIBUTIONS FROM INVESTORS

AIFs or the separate schemes launched by them issue Units to its investors which may be in different classes each having specific rights attached to them. These are generally spelt out in the Private Placement Memorandum. Whilst issuing the units, the following are some of the critical regulatory aspects which need to be kept in mind:

- Each scheme of the AIF shall have corpus of at least ₹ 20 crores.
- The AIF shall not accept from an investor, an investment/contribution of value less than ₹ 1 crore, except in case of investors who are employees or directors of the AIF or of the Manager, from whom the minimum value of investment/ contribution shall be ₹ 25 lakhs.
- The Manager or Sponsor shall have a continuing interest in the Alternative Investment Fund of not less than 2.5% of the corpus or ₹ 5 crores, whichever is lower, in the form of investment/ contribution in the AIF and such interest shall not be through the waiver of management fees. Further, for a Category III AIF, the continuing interest shall be not less than 5% of the corpus or ₹ 10 crores, whichever is lower.
- No scheme of the AIF shall have more than one thousand investors, and the provisions of the Companies Act, 2013 shall apply to the AIF, if it is formed as a company. Accordingly, the fund shall not solicit or collect funds except by way of private placement.

The following are certain accounting issues which arise with regard to contributions from investors/unit holders:

- All units which are initially issued to the investors are at the prescribed par/face value and hence have to be recorded and accounted for accordingly.
- As discussed earlier, Category I and II AIFs are close ended and hence the units initially issued to the investors/contributors would be at par and accounted for accordingly. However, in practice many such Funds or the individual schemes therein have an ***"open window"*** period, which is specified in the Placement Memorandum, whereby the subscription is open for a fixed subsequent period. In such cases investors who contribute subsequently are issued units at the NAV which may be higher or lower than the par value which is accounted for under Accumulated Surplus/ Deficit in the Income and Expenditure Account or under **Unit Premium Reserve**. *There is currently no clarity on how these balances need to be considered, especially at the time of the final distribution. Accordingly, it is desirable that the AIF Regulations provide for a uniform accounting treatment by recording such difference in the Unit Premium Reserve as well as the subsequent treatment/ adjustment thereof as is the case with Mutual Funds.*
- In the case of Category III AIFs which are open ended, similar accounting considerations as discussed above are applicable for the purchase and redemption of units on an ongoing basis at the NAV.

Apart from the accounting treatment discussed above, in case the accounts of the AIF are required to be ***consolidated by the sponsor*** *for the reasons discussed earlier, and the sponsor is required to follow* ***Ind AS,*** *assessing the* ***classification of the units as a Financial Liability or Equity*** *as per the requirements of* ***Ind AS-32 on Financial Instruments – Presentation****, in the consolidated financial statements is crucial.* For this purpose it would be relevant to briefly understand the meaning of the terms Financial Liability and Equity as per Ind AS-32.

As per Ind AS-32, a Financial Liability is defined as any liability that is a contractual obligation:

(i) To deliver cash or another financial asset to another entity or

(ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavourable to the entity.

As per Ind AS-32, an Equity Instrument is defined as any contract that evidences residual interest in the assets of an entity after deducting all of its liabilities. Accordingly, a financial instrument will be treated as equity if it meets both the following criteria:

a) There is no obligation (direct or indirect) to deliver cash or another financial asset or to exchange financial assets or financial liabilities under conditions potentially unfavourable to the issuer; and

b) The issuer will exchange fixed amount of cash or another financial asset for a fixed number of its own equity instruments.

Based on an analysis of the above definition since AIFs, whether open ended or close ended, have a fixed tenure and the AIF or the scheme is contractually obliged to deliver cash based on the NAV, the units in such cases would be treated as a financial liability for Ind AS purposes.

INVESTMENT ACCOUNTING

Investments represent the single most important item in the financial statements of the AIF. Before going into the specific accounting considerations, it would be relevant to examine the key regulatory guidelines governing investments, which would determine the accounting treatment.

Regulatory Investment Conditions and Restrictions

The AIF Regulations prescribe a general set of investment restrictions that are applicable to all AIFs and further prescribe a specific set of investment restrictions that are applicable for each category of AIFs. Further, co terminus with the investment conditions and restrictions, AIFs are also permitted to borrow or engage in approved leveraging strategies. The following is the list of ***general investment conditions*** applicable to ***all AIFs***:

a) ***The type of companies/instruments in which investments can be made depend upon the category under which registration is sought which is covered at the beginning of this article;***

b) Co-investment in an investee company by a manager/sponsor should not be on more favourable terms than those offered to the AIF;

c) Only a specific percentage of the investible funds (25% for Category I and II AIFs and 10% for Category III AIFs) can be invested in a single investee company;

d) AIFs should not invest in associates except with the approval of 75% of investors by value of their investments in the AIF; and

e) The uninvested portion of the investible funds may be invested in liquid mutual funds or bank deposits or other liquid assets of higher quality such as Treasury Bills, Collateralised Borrowing and Lending Obligations ("CBLOs"), commercial papers, certificates of deposits, etc. till deployment of funds as per the investment objective.

The following table summarises the key regulatory investment restrictions that are applicable in respect of the various categories of AIFs:

AIF Category	Investment Restrictions
Category I	a) In investee companies or venture capital undertakings or in special purpose vehicles or in limited liability partnerships or in units of other AIFs specified in the AIF Regulations. b) In the units of the same sub-category of Category I AIFs. However, this investment condition is subject to the further restriction that Category I AIFs are not allowed to invest in the units of Fund of Funds.
Category II	a) In unlisted investee companies or in units of other AIFs as may be specified in the placement memorandum. b) In the units of Category I and Category II AIFs. This is subject to the restriction that Category II AIFs cannot invest in the units of Fund of Funds. c) They may engage in ***hedging*** subject to such guidelines that may be prescribed by SEBI.
Category III	a) In securities of **listed** or unlisted investee companies or **derivatives or complex or structured** products. b) In the units of Category I, Category II and Category III AIFs. This is subject to the restriction that Category III AIFs cannot invest in the units of Fund of Funds.

Based on the analysis of the above regulatory guidelines, AIFs generally invest in the following types of instruments:

- Listed and Unlisted equity and preference shares
- Listed and Unlisted debt securities
- Various money market instruments and liquid mutual funds
- Derivatives and hedging instruments (discussed in the subsequent section)

The accounting treatment and certain other related issues are briefly discussed hereunder:

Accounting Treatment and Issues

In the absence of specific regulatory directives like in the case of mutual funds, AIFs in the normal course are required to follow the principles enshrined in the Accounting Standards. Assuming that most of the AIFs would have to follow Indian GAAP rather than Ind AS, the principles for classification, recognition, measurement and disclosure as per AS-13 on Accounting for Investments issued by ICAI, which are briefly discussed hereunder, need to be followed by AIFs, to the extent applicable and relevant :

- All investments need to be classified as Long Term and Current. In the case of AIFs in the normal course all investments would be long term since the intention is to provide funding support to entities and also generate returns for investors which has a horizon for more than one year. Only the uninvested portion pending deployment which is permitted to be invested in liquid mutual funds and other money market instruments as discussed earlier can be classified as current.
- All other investments should be recorded at the cost of acquisition which includes brokerage, fees and duties. Care should be taken to capitalise to investments only the

unavoidable and statutory costs without which it would not be possible to make the investments. *Costs like due diligence fees and other similar costs should not be capitalised since they only facilitate investment decisions and are not a part of the acquisition.*

- Long term investments should subsequently be continued to be carried at cost unless there is a decline in value other than temporary, in which case the same needs to be provided for. This depends upon various factors like market value, investee's results and cash flows, extent of the stake in the investee, restrictions on distribution etc. *This assessment is independent of the NAV which needs to be calculated as discussed later.*

*Whilst the above treatment is generally followed, there are certain AIFs which **subsequently measure investments at the NAV** on the ground that **AS-13 does not apply to mutual funds, venture capital funds and related asset management companies,** since venture capital funds are not defined in the Standard. Further, as discussed earlier, the fact that venture capital funds registered under the erstwhile regulations are now governed by the AIF Regulations, in a way supports this view. In such cases the difference between the cost and NAV should be recognised as an **unrealised gain or loss.** In my view, cost is the preferred option for close ended funds whilst NAV based recognition option could be adopted by open ended funds.*

However if for the reasons indicated earlier, in rare situation, the AIF has to adopt Ind AS, instead of cost, the fair value model for accounting and recognition would need to be adopted along with the other requirements as laid down in Ind AS-109 on Financial Instruments Recognition and Measurement which could be the subject matter of a separate article and hence not discussed due to space constraints.

Borrowing and Leverage

As per the AIF Regulations, Category I and II AIFs shall not borrow funds directly or indirectly or engage in leverage except for meeting temporary funding requirements for more than thirty days, on not more than four occasions in a year and not more than 10% of its investible funds. Category III AIFs can engage in leverage or borrow subject to consent from investors in the fund and subject to a maximum limit as may be specified by SEBI.

In the absence of any specific guidance under Indian GAAP, the borrowings are to be recorded at the amounts received and the interest thereon needs to be also recorded based on the contracted rate. *However, as discussed above, the treatment could be different if Ind AS is applicable.*

DERIVATIVES ACCOUNTING

As seen above, Category III AIFs are permitted to deal in derivatives for which specific approvals are required. Generally approvals are granted to only deal in ***equity index and stock options and futures***. Recently, AIFs are also permitted to deal ***in commodity derivatives.***

The ICAI has issued a **Guidance Note on Accounting for Derivatives** which is applicable from the financial years commencing from 1st April, 2016 which is broadly in line with the IFRS/Ind AS requirements. The underlying theme as per the Guidance Note is that all derivatives need to be recognised on the balance sheet and measured at fair value since a derivative contract represents a contractual right or an obligation.

Since majority of the AIFs deal in equity index stock options and futures (collectively referred to as Equity Derivatives), it would be pertinent to briefly understand the meaning thereof followed by a discussion on the accounting treatment for the same.

Equity Index Futures and Equity Stock Futures

An equity index futures contract is a futures contract in which the underlying asset is an equity index, e.g., S&P CNX NIFTY or BSE

SENSEX. In other words, it is a contract to buy or sell equity index at an agreed amount on a specified future date.

An equity stock futures contract is a futures contract in which the underlying asset is a security, e.g., equity shares of Tata Steel Ltd., equity shares of Infosys Limited, etc. In other words, it is a contract to buy or sell a security at an agreed amount on a specified future date.

In case of equity index futures, the underlying asset is equity index itself (e.g., BSE SENSEX, S&P CNX NIFTY), whereas in case of equity stock futures, the underlying asset is a security (e.g., equity shares of a company).

By its very nature, the index cannot be delivered on maturity of the contract. As such, the settlement of an equity index futures contract takes the form of payment of the difference between the price as agreed in the contract (contract price) and the value of the index on the maturity date (Settlement Date), in cash. In contrast, an equity stock futures contract can be settled either through delivery of security for which the contract was entered into or by receipt/payment of the difference between contract price and the value of the security for which the contract was entered into, in cash, just like equity index futures. At present, in India, equity stock futures contracts are settled through cash.

Equity Index Options and Equity Stock Options

Equity index options are a type of derivative instruments whereby a person gets the right to buy or sell an agreed number of units of equity index on a specified future date.

Equity stock options are a type of derivative instruments whereby a person gets the right to buy or sell an agreed number of units of a security on or before a specified future date.

At present, in India, trading in equity index options is allowed in two indexes, viz., BSE SENSEX and S&P CNX NIFTY and equity stock options are allowed in certain specified securities listed on the stock exchanges.

In case of equity index options, the underlying asset is equity index itself (e.g., BSE SENSEX, S&P CNX NIFTY), whereas in case of equity stock options, the underlying asset is a security (e.g., equity shares of a company).

Equity index options are of European style, i.e., buyer/holder can exercise his option only on the day on which the option expires, whereas equity stock options are of American style, i.e., the buyer/holder can exercise his option at any time before the Expiry Date or on the date of expiry itself.

By its very nature, the index cannot be delivered on maturity of the contract. As such, the settlement of an equity index options contract takes the form of payment of the difference between the Strike/Exercise Price and the value of the index on the Expiry Date, in cash. In contrast, equity stock options contract can be settled either through delivery of security for which an options contract was entered into or by payment of the difference between the Strike/Exercise Price and the value of the security for which the options contract was entered into, in cash, just like equity index option. At present, in India, equity stock options are settled through cash.

Accounting Treatment for Equity Derivatives

- Equity Index/Stock Futures are required to be marked-to-market generally on a daily basis.
- On final settlement or squaring-up of contracts for Equity Index/Stock Futures, the profit or loss is to be calculated as difference between settlement/squaring-up price and contract price. Accordingly, profit or loss on settlement or squaring-up is recognised in the Statement of Income and Expenditure.

- Premium paid for the options should initially be included in "Equity Index/ Stock Option Premium Account" as an asset.
- When the option contracts are squared-up before expiry of the options, difference between the premium paid at the time of purchase of option contracts and the premium prevailing on the date when the contracts are squared up, should be recognised in the Statement of Income and Expenditure. On expiry of the contracts, the difference between final settlement price and the strike price is transferred to the statement of Income and Expenditure and premium paid for buying the option is recognised in the Statement of Income and Expenditure for all squared up/settled contracts.

DETERMINATION OF NAV

The performance of the AIF (and in certain cases as indicated above, the accounting) is measured on the basis of the NAV and hence its determination is crucial. Apart from it being used as a basis for rewarding the investors it is also used for determining the various expenses like Management Fees, Trustee Fess etc., as indicated earlier and hence it has a crucial role in accounting even if the AIF adopts the cost model of accounting for investments, as discussed earlier. Finally, the NAV is also important for determining the number of units which need to be allotted to investors who subscribe units during the ***open window period***, as discussed earlier in case of close ended funds and also for fresh allotments and redemptions in case of open ended funds.

NAV essentially boils down to determining the valuation of the assets of the AIF, primarily represented by its investment portfolio on a periodical basis, as follows, as per the AIF Regulations.

- Category I and Category II AIFs shall undertake valuation of their investments, atleast once in every six months, by an independent valuer. However, such period may be enhanced to one year on approval of at least 75% of the investors by value of their investment
- Category III AIFs shall ensure that calculation of the NAV is independent from the fund management function and such NAV shall be disclosed to the investors at intervals not longer than a quarter for close ended Funds and at intervals not longer than a month for open ended funds.

Unlike in the case of Mutual Funds, wherein SEBI has laid down detailed guidelines for calculating the NAV, there are no specific guidelines for AIFs. Accordingly, taking a cue from the Mutual Fund guidelines and after factoring in the difference in the business model for AIFs *vis-à-vis* Mutual Fund, with the latter driven by more frequent churning of its portfolio, the following are some of the broad parameters which could be used for calculating the NAV by AIFs:

- In respect of quoted securities where there is frequent trading, the quoted market price based on the stock exchange having the maximum trading volume can be used.
- In case of quoted securities where the trading volume is thin, appropriate adjustments to the last available market price would need to be determined factoring in the illiquidity discount, PE multiples of comparable companies etc.
- In case of unquoted equity shares the fair value would need to be determined based on observable and/or unobservable inputs and other assumptions by a competent valuer based on generally accepted valuation methodologies. A detailed discussion in respect thereof is beyond the scope of this article.
- In respect of unquoted debt securities inputs need to be taken from the

FIMMDA yield curves/"CRISIL Bond Valuer" or other similar data based on the comparable tenor and yield of the instrument.

Whilst the above are the broad guidelines, valuation, especially in respect of unquoted securities being very subjective, the Trustee and the Investment Manager would need to lay down a proper policy after discussing the same with investors and other stakeholders. *It is strongly recommended that SEBI lays down broad guidelines on the same lines as done for Mutual Funds to ensure greater uniformity, comparability and transparency.*

PERFORMANCE MANAGEMENT FEES

Keeping in mind the fact that profit sharing/ performance management fees are charged by portfolio/investment managers upon exceeding a hurdle rate or benchmark as specified in the agreement, coupled with the fact that there is no uniformity in practice on how the profit/ performance of the portfolio be computed, SEBI, *vide* its circular dated 5th October, 2010 has advised that, henceforth, *profit/performance shall be computed on the basis of* ***"high water mark principle"*** *over the life of the investment, for charging of performance/profit sharing fee.*

As per the aforesaid circular, High Water Mark shall be the highest value that the portfolio/account has reached. Value of the portfolio for computation of high watermark shall be taken to be the value on the date when performance fees are charged. For the purpose of charging performance fee, the frequency shall not be less than quarterly. The portfolio manager shall charge performance based fee only on ***increase in portfolio value in excess of the previously achieved high water mark.***

It would be useful at this stage to understand this concept with the help of an example:

Let us consider that frequency of charging of performance fees is annual. A client's initial contribution is ₹ 1,00,000, which then rises to ₹ 1,20,000 in its first year; a performance fee/profit sharing would be payable on the return of ₹ 20,000. In the next year the portfolio value drops to ₹ 1,10,000 hence no performance fee would be payable. If in the third year the Portfolio rises to ₹ 1,30,000, a performance fee/profit sharing would be payable only on the profit of ₹ 10,000 which is portfolio value in excess of the previously achieved high water mark of ₹ 1,20,000, rather than on the full return during that year from ₹ 1,10,000 to ₹ 1,30,000.

The Circular also provided that in case of interim contributions/withdrawals, performance fees may be charged after appropriately adjusting the high water mark on proportionate basis.

CONCLUSION

The above discussion is based on generally accepted industry practices and attempts to codify the best practices in accounting. It is however desirable if more specific guidance comes through from SEBI on the various accounting related issues.

❍❑❍

Youth and beauty vanish, life and wealth vanish, name and fame vanish, even the mountains crumble into dust. Friendship and love vanish. Truth alone abides.

— *Swami Vivekananda*

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Alternative Investment Funds and Venture Capital Funds Direct Tax – Key Provisions

Background

Alternative Investment Funds (AIFs) and Venture Capital Funds (VCFs) provide long-term and high-risk capital to a wide variety of ventures at all stages of evolution, thereby creating stability and entrepreneurial capability, and in turn, contributing to the nation's economic growth.

The Securities and Exchange Board of India (SEBI) initially issued the SEBI (VCF) Regulations, 1996 (VCF Regulations), endeavouring to channelise capital available with high net-worth Individuals and institutions into unlisted companies and for professional management of these investments. These regulations had some challenges and the industry represented that these regulations be looked at afresh.

Subsequently, considering representations of and on having discussions with various stakeholders, the SEBI issued the SEBI (AIF) Regulations, 2012 (AIF Regulations), endeavouring to formulate an all-encompassing regulation for pooling vehicles, *inter alia*, enabling domestic asset managers to further diversify into launching a variety of funds (including private equity funds, debt funds, hedge funds, etc). Let us now see what an AIF/VCF looks like structurally.

A typical AIF/VCF structure involves the following key parties –

- ***AIF/ VCF***

An AIF can be set up either as a company or a trust or a limited liability partnership (LLP); whereas a VCF can be set up as a company or a trust.

As per the AIF Regulations, depending on the investment strategy, an AIF can be registered as Category I, II or III AIF (these categories are explained in a previous Chapter).

Generally, AIFs/VCFs are organised as trusts as against a company or an LLP, key differentiating factors being, potential tax leakage at the AIF/ VCF level [income-tax as well as tax on distribution, in the case of a company], simplicity and flexibility in incorporation, management and governance, and minimal statutory disclosure requirements as compared to a company or an LLP.

- Unit holders [residents as well as non-residents]

- Investment Manager [can be a company or an LLP]
- Trustee to AIF/VCF, where it is set up as a Trust

This Article acquaints the reader with the key provisions of the Income-tax Act, 1961 (Act), governing taxation of AIFs, VCFs and their unit holders, and the key reporting requirements.

[I] Taxation of AIFs/ VCFs and their unit holders - Introduction

The Act provides for 'pass-through taxation'[1] regime for Category I and II AIFs[2] and VCFs[3], with certain exceptions.

Category III AIFs are not covered under the pass-through taxation frame-work, and would be governed by normal provisions of the Act.

The Act also contains provisions relating to deduction of tax at source (TDS) and reporting requirements, for AIFs and VCFs.

For ease of reference, listed below are the sections of the Act which are specifically applicable to Category I and II AIFs, VCFs, and unit holders.

Section of the Act	Gist of the Section
AIF	
10(23FBA)	Exemption for income of Category I and II AIFs (other than business income)
10(23FBB)	Exemption for business income in the hands of unit holders
115UB	Pass-through taxation for unit holders of Category I and II AIFs, reporting requirements
139(4F)	Return of income by Category I and II AIFs
194LBB	TDS by Category I and II AIFs on payment of income to unit holders
VCF	
10(23FB)	Exemption to VCF in respect of income from investments in Venture Capital Undertakings (VCU)[4]
115U	Pass-through taxation for unit holders of VCFs for certain income, reporting requirements
139(4C)(ec)	Return of income by VCF

[II] Taxation of <u>Category I and II AIFs, VCFs</u> and their unit holders

<u>Tax Exemption for AIFs and VCFs, and provisions applicable to unit holders in AIFs</u>

As per **section 10(23FBA)** of the Act, any income earned by **Category I and Category II AIFs,** other than the income chargeable under the head 'Profits and Gains of Business or Profession', is exempt from tax.

Correspondingly, as per **section 10(23FBB)** of the Act, proportion of income paid or credited to the unit holders, which is in the nature of business income, shall be exempt from tax, as the same is taxable in the hands of the Category I and II AIFs.

In the case of VCFs, as per **section 10(23FB)** of the Act, any income from investments made in VCUs is exempt in the hands of VCF, and therefore chargeable to tax in the hands of the unit holders.

1 Taxation of income in the hands of the unit holders in the same manner as if it were the income accruing or arising to the unit holders, had the investments made by the AIF/ VCF been made directly by the unit holders. This is explained along with other aspects in subsequent paragraphs.

2 Category I and II AIFs are defined as 'Investment Fund' under section 115UB of the Act.

3 If a VCF registers itself under the AIF Regulations, it would be governed by the provisions applicable to Category I AIFs.

4 As defined under section 10(23FB) of the Act.

Taxation of income, other than income from investments made in VCUs, is discussed separately.

'Pass-through' status to AIFs and taxation of unit holders

As per **section 115UB(1)** of the Act, income earned by AIF is chargeable to tax in the hands of the unit holders as if it were the income of the unit holders had the investments been made directly by them. However, business income would be taxable in the hands of the AIF.

Thus, for the purposes of levy of income-tax, an AIF is treated as a 'pass-through' or transparent entity which is unlike the scheme of taxation of partnership firms or trusts where the taxable unit is the firm or trustee.

Characterisation of income

Section 115UB(3) of the Act provides that income paid or credited by the AIF to the unit holders shall be deemed to be of the same nature and in the same proportion in the hands of the unit holders as if it had been received by, or accrued or arisen to the AIF.

Based on the above, while characterisation of income would take place at the AIF level, taxation would be at the unit holder's level [subject to provisions of section 10(23FBB) of the Act].

Below illustration depicts the implications of the above discussed provisions.

Particulars	Amount ₹
Income received by AIF	
Business Income [BI]	100
Capital Gains [CG]	600
Other Income [OI]	300
Total	**1,000**

Particulars	Amount ₹
ABC unit holder's share	**10%**
Income in the hands of ABC	
BI	10
CG	60
OI	30
Total	100
Income taxable in the hands of AIF [BI]	100
Income taxable in the hands of ABC [Proportionate CG + OI]	90
Income exempt in the hands of ABC [Proportionate BI]	10

Losses not to be passed on to unit holders

As per **section 115UB(2)** of the Act, where for any assessment year, the net result of computation of total income of AIF [without giving effect to section 10(23FBA) of the Act] is a loss, under any head of income, and such loss cannot be set-off against any other head of income, then such loss shall not be passed on to the unit holders, but carried forward and set-off by the AIF in accordance with the set-off and carry forward provisions contained in the Act.

Tax rates applicable to AIFs

As per **section 115UB(4)** of the Act, total income of the AIF shall be charged to tax at the rate or rates specified in the Finance Act of the relevant year (where the AIF is set up as a company or as an LLP) and at Maximum Marginal Rate ('MMR') i.e. 30%, where AIF is set up as a trust[5].

No tax on distribution

As per **section 115UB(5)** of the Act, dividend distribution tax (DDT) [Chapter XII-D] and tax on distributed income [Chapter XII-E] shall not be levied on the income distributed by the Category I and II AIFs to their unit holders.

5 As per section 10(23FBA) of the Act, income (other than business income) of Category I and II AIFs, is exempt from tax; and therefore, this provision will apply primarily in relation to the business income of Category I and II AIF.

Taxability of undistributed income on accrual basis

Section 115UB(6) of the Act provides that where any income of an AIF is not paid or credited to the unit holders during a particular financial year, then such undistributed income shall be deemed to have been credited to the unit holders on the last day of that year. Therefore, the undistributed income shall be deemed to be taxable in the hands of unit holders irrespective of payment or credit to the unit holders.

Taxation of VCFs, and their unit holders

Section 115U[6] of the Act provides for a similar taxation frame-work for VCFs and their unit holders, subject to certain differences.

Annexure 1 depicts the key differences of provisions applicable to Category I and II AIFs and their unit holders, *vis-à-vis* VCFs and their unit holders.

[III] Filing of return of income

Category I and II AIFs and VCFs[7] are required to file return of income under **section 139(4F) and section 139(4C)(ec)** of the Act, respectively, in Form ITR-7.

The due date for filing the return of income is 31st July of the Assessment Year.

In the case of a company or any other person to whom tax audit provisions [section 44AB of the Act] are applicable, the due date would be 30th September of the Assessment Year.

[IV] TDS on payments to AIF

In exercise of the powers conferred by section 197A of the Act, the Central Government has issued a Notification[8], as per which no tax shall be deducted on payment of the nature specified under section 10(23FBA) of the Act, i.e. payments to Category I and II AIFs, except for in the nature of business income.

Therefore, where the Category I and Category II AIFs earn income, which is not in the nature of business income, the AIFs would need to intimate the payers such that tax is not deducted on such payments to be made to Category I and II AIFs.

This notification is not applicable to Category III AIFs and VCFs. Therefore, payments to Category III AIFs and VCFs may be subject to TDS, wherever applicable.

[V] TDS on distribution to unit holders by Category I and II AIFs

As per **section 194LBB** of the Act, Category I and II AIFs are required to deduct tax on all income (other than business income) that is paid or credited to their unit holders as follows:

- Resident unit holders – at 10 per cent;
- Non-resident unit holders – at rates in force[9]. However, no TDS is required in respect of any income that is not chargeable to tax under the provisions of the Act.

These provisions, however, have created some ambiguity in relation to TDS on distribution of exempt income (dividends) to resident unit holders, as the provisions, as worded, would require deduction of tax on such income.

Unit holders could obtain NIL/ lower TDS certificates from the tax authorities to receive income from the AIF without TDS/ at lower TDS rate.

TDS provisions are not applicable in the case of distribution by VCFs[10]*.*

6 If a VCF registers itself under the AIF Regulations, it would be governed by provisions of section 115UB of the Act.

7 Where the total income before giving effect to the provisions of section 10(23FB) of the Act exceeds maximum amount which is not chargeable to tax.

8 Notification No. 51/2015 dated 24th June 2015.

9 The rate of income-tax specified in this behalf in the Finance Act of the relevant year or rates specified in the relevant Double Taxation Avoidance Agreement (DTAA), whichever is more beneficial.

10 Section 115U(4) of the Act.

[VI] Taxation of Category III AIFs, and Taxation of VCFs in relation to income other than from investments made in VCUs

Taxation of Category III AIFs, and taxation of VCFs in relation to income other than income from investments made in VCUs, is governed by normal provisions of the Act, basis the legal form of such AIFs and VCFs.

Category III AIF/ VCF set up as a company

Where the Category III AIF/ VCF is set up as a company, income would be taxable in the hands of the AIF/ VCF at the rate of 10% - 30% depending on the characterisation of income, subject to provisions of Minimum Alternate Tax (MAT) [section 115JB of the Act, discussed later].

On distribution to the unit holders, the Company would need to pay DDT under section 115-O of the Act, at an effective rate of 20.56%.

Dividend, which has been subject to DDT, would be exempt in the hands of unit holders under section 10(34) of the Act (subject to section 115BBDA of the Act).

This is one of the reasons why an AIF in the form of a company is not preferred.

Category III AIF set up as an LLP

Where the Category III AIF is set up as an LLP, income would be taxable in the hands of the LLP at 10% - 30% depending on the characterisation of income, subject to provisions of Alternate Minimum Tax (AMT) per **section 115JC** of the Act (discussed separately). The share of income from the LLP to the unit holders would be exempt in the hands of the unit holders as per **section 10(2A)** of the Act.

In both the above cases (i.e., receipt of dividend from the company and share of income from LLP), it will be pertinent to analyse the applicability of section 14A of the Act in relation to disallowance of expenditure on exempt income in the hands of the unit holders.

An AIF set up as an LLP is usually less popular than an AIF set up as a trust. In recent times, however, one has seen LLPs also becoming popular.

Category III AIF/ VCF set up as a trust

Where a Category III AIF/ VCF is set up as a trust, the taxation would be governed by general provisions of trust taxation.

Revocable transfer to a trust (Section 61 to 63 of the Act)

As per section 61 of the Act, all income arising to any person by virtue of a revocable[11] transfer of assets shall be chargeable to income-tax as the income of the transferor and shall be included in his total income.

Where the Category III AIF/ VCF is set up as a trust and the transfer thereto is regarded as revocable, income arising to AIF/ VCF ought to be taxable in the hands of the settlors or unit holders, as the case may be.

Where the AIF/ VCF is irrevocable trust (Section 160, 161 and 164 of the Act)

Typically, to avoid administrative difficulties[12], Category III AIFs/VCFs are set up as irrevocable trusts, where basis the provisions of trust taxation, tax liability is discharged at the AIF/ Trustee level.

It also becomes relevant to determine if the irrevocable AIF/ VCF trust is determinate or indeterminate.

Basis ***Explanation 1 to section 164*** of the Act, it can be construed that a trust is considered

11 As per section 63 of the Act, a transfer is considered as 'revocable' where: (i) it contains any provision for the re-transfer directly or indirectly of the whole or any part of the income or assets to the transferor, or (ii) it, in any way, gives the transferor a right to reassume power directly or indirectly over the whole or any part of the income or assets; The term 'transfer' is defined to include any settlement, trust, covenant, agreement or arrangement.

12 Payment of taxes, determining share of unit holders in income and tax liability, etc.

to be determinate if it fulfils the following two conditions:

- Names of the beneficiaries are specified in the indenture of trust; and
- Shares of the beneficiaries are expressly stated and are ascertainable as such on the date of the indenture of trust.

As a corollary, an indeterminate trust would be the one which does not satisfy either of the conditions mentioned above.

In the context of AIFs[13], the CBDT[14] has clarified that, in a situation where the trust deed does not name the unit holders or does not specify their beneficial interests, the trust will be characterised as an 'indeterminate trust' and the entire income of the AIF would be taxable as per section 164 of the Act.

Thus, the indenture of trust should mention the name and beneficial interest of the unit holders at the time of creation of trust to qualify as a 'determinate trust'.[15] This aspect needs evaluation on a case-by-case basis.

<u>*Taxability in the case of determinate trusts*</u>

As per **section 161** of the Act, where a trust qualifies as irrevocable and determinate, the trustees of the trust are liable to tax in their capacity as 'representative assessee'[16] in the like manner and to the same extent, as the beneficiaries (unit holders).

However, where the income includes business profits, the entire income of the trust (in the case of VCF, income other than income from investments in VCUs) will be taxed at MMR in the hands of the trustee.

<u>*Taxability in case of indeterminate trusts*</u>

As per **section 164** of the Act, income of an indeterminate trust is taxable in the hands of the trustees, as a representative assessee, at MMR.

Where the income is subject to a special rate of tax under the Act, such as short-term capital gains on transfer of equity shares (15%) and long-term capital gains on transfer of equity shares (10%) subject to Securities Transaction Tax, it could be argued that the special rate should be considered as the MMR; however, the litigation cannot be ruled out.

Section 162 of the Act enables the Trustee to recover the taxes, if any, paid on behalf of the unit holders.

Filing of return of income by Category III AIFs

Depending on the legal form of the Category III AIF (company/ LLP/ trust), it would be required to file the return of income in the prescribed form on or before the prescribed due date.

[VII] Relevance of Double Taxation Avoidance Agreements for non-resident unit holders

As discussed above, section 115UB and section 115U of the Act provides for taxation directly in the hands of unit holders in AIFs (except for the business income) and VCFs, respectively.

In this regard, it would be relevant to note that, as per section 90(2) of the Act, the provisions of

13 Prior to 1st April 2016, in case of VCFs [either registered under VCF Regulations or as a Category I AIF under AIF Regulations which were governed by section 10(23FB) of the Act] set up as a trust, any income other than income from investments in VCUs was subject to Trust taxation.

14 *Vide* Circular No. 13/2014, dated 28th July 2014.

15 There are judicial precedents [AIG Advance Ruling P. No. 10 of 1996] which have held that where the manner of identifying the unit holders and their proportionate shares is defined in the trust deed, the trust should be considered as a determinate trust. Where an action is taken in pursuance to the circular, it could be challenged before the Tribunal/ Courts and the interpretation provided by such Tribunal/ Courts could prevail notwithstanding the circular.

16 Section 160

the Act shall apply to an assessee, who is eligible to claim benefits under a Double Taxation Avoidance Agreement (DTAA) which India has entered into with the country of which such assessee is resident, only to the extent beneficial as compared to the provisions of that DTAA.

Based on the provisions of the section 115UB and section 115U of the Act, read with section 90(2) of the Act, non-resident unit holders of AIFs, and VCFs should be eligible to claim DTAA benefits, wherever applicable.

For claiming DTAA benefits, section 90(4) of the Act provides that the non-resident assessee, to whom a DTAA applies, shall not be entitled to claim any relief under such DTAA unless a Tax Residency Certificate (TRC) stating the prescribed particulars[17], is obtained from the Government of that country.

Further, such assessee would be required to furnish Form No. 10F, where all the prescribed particulars are not expressly stated in the TRC.

In the case of a large unit holder base, it may not be practically possible for the Trustee to evaluate each unit holder's eligibility to claim DTAA benefits.

[VIII] Taxation in the hands of non-resident unit holders of income from AIF's/ VCF's overseas Investments

The AIF Regulations, and VCF Regulations (read with relevant foreign exchange regulations) permit AIFs, and VCFs respectively, to make investments outside India. Given the pass-through taxation framework, it is arguable that if any income, which is passed through to non-resident unit holders of the AIF/VCFs, is not accruing or arising in India, the same ought not to be taxable in India.

At the same time, if the income from overseas investments, is received in the Indian bank account of the AIFs/ VCFs, it may be said to be received in India, and thereby, taxable in the hands of non-resident unit holders.

[IX] Applicability of indirect transfer provisions

Indirect transfer (IDT) provisions[18] were introduced to tax gains arising from the transfer of share or interest in a foreign company or foreign entity whose value is derived, directly or indirectly, 'substantially' from assets located in India.

Category I and II Foreign Portfolio Investors (FPI) were granted exemption from the IDT provisions effective 1st April 2015.

Concerns were expressed by several stakeholders that, on account of the IDT provisions, non-resident funds investing in India suffer multiple taxation of the same income at the time of subsequent redemption or buyback at the offshore level.

Following such representations, the CBDT issued a Circular[19] clarifying that the IDT provisions will not apply to income accruing or arising to a non-resident on account of redemption or buyback of share/ interest held indirectly in specified funds in India (being a VCF or a Category I or II AIF), if such income accrues or arises from or in consequence of transfer of shares or securities held in India by the specified funds, and such income is chargeable to tax in India in the hands of the specified funds.

17 Rule 21AB of the Income-tax Rules, 1962 (Rules).

18 Explanation 5, 6 and 7 to section 9(1)(i) of the Act.

19 F.No. 500/10/2017-FT&TR-IV, Circular 28/2017 dated 7th November 2017.

[X] Other key income-tax provisions

Besides the provisions which specifically deal with the taxation of AIFs/ VCFs and their unit holders, it will be pertinent to take a look at other provisions of the Act governing the taxability of individual income components, which would be relevant for AIFs/ VCFs or their unit holders, as the case maybe. Some of these provisions are discussed below -

Dividend

Dividend declared by domestic companies is exempt from tax under section 10(34) of the Act, subject to DDT being paid by the dividend paying company.

As per **section 115BBDA** of the Act, dividend income from domestic companies, exceeding Rs 10 lakhs, shall be chargeable to income-tax at 10% on gross basis in the hands of specified assessees[20] (which would include AIFs/VCFs).

An interesting issue arises where all the unit holders of the AIF (particularly, Category III set up a trust) are taxpayers to whom section 115BBDA of the Act does not apply, e.g. resident companies, would section 115BBDA of the Act apply to dividends received by such an AIF. Such cases may be prone to litigation.

Interest

Classification of interest income is a matter of dispute with contradicting judicial precedents. Whether interest income would be assessable as 'business income' or 'income from other sources' would depend upon the nexus it has with the AIF's activities.

Depending on the tax residence of the unit holders, the nature of interest earned and the legal form of the AIF, the interest income could be taxable at 5% - 40%.

Gains on transfer of securities

Gains arising from transfer of securities may be treated either as 'capital gains' or as 'business income' for income-tax purposes, depending upon whether such securities are held as capital asset or stock-in-trade.

Readers may refer to the following CBDT communications providing guidance on the classification of securities –

- Instruction No. 1827, dated 31st August 1989
- Circular No. 4/2007, dated 15th June 2007
- Circular No. 6/2016, dated 29th February 2016
- Letter F No. 225/12/2016/ITA.II, dated 2nd May 2016
- Letter F No. 225/12/2016/ITA.II, dated 24th January 2017

Further, various courts have dealt with this aspect.

In the context of Category I and II AIFs, which primarily invest in the shares of unlisted companies, the CBDT[21] has clarified that the income arising from transfer of unlisted shares would be considered under the head 'capital gains', irrespective of period of holding, except in the following situations where the Assessing Officer would take an appropriate view:

- The genuineness of transactions in unlisted shares itself is questionable;
- The transfer of unlisted shares is related to issue pertaining to lifting of corporate veil;
- The transfer of unlisted shares is made along with the control and management of underlying business.

CBDT has subsequently issued a clarification F. No. 225/12/2016/ITA.II dated 24th January

20 Specified assessee is defined to mean a resident person, other than (i) a domestic company; (ii) a fund or institution or trust or any university or other educational institution or any hospital or other medical institution as referred in the ITA; and (iii) a charitable trust or institution registered under the Act.

21 Circular F No. 225/12/2016/ITA.II dated 2nd May 2016.

2017, basis which the exception in relation to transfer of unlisted shares along with control and management of underlying business as discussed above, shall not be applicable, to Category I and II AIFs.

Capital gains on transfer of securities could be taxable at the rate of 10% - 40% depending on the residential status of the unit holders, nature of securities, mode of acquisition and transfer, etc.

Where the income on transfer of securities is considered as business income, the same could be taxed at the rate of 30%/40% depending on the residential status of the unit holders.

Business Income in the hands of Category I and II AIFs on sale of securities would be taxable at the rate of 30%.

Transfer to be at fair value under section 50CA of the Act

Where shares, other than quoted shares[22], are transferred for a value less than the fair market value (FMV) [computed as per **Rule 11UAA read with Rule 11UA(1)(c)** of the Rules], then the FMV shall be deemed to be the sale consideration and the capital gains will be determined accordingly.

Receipt of shares at lower than fair value

Section 56(2)(x) of the Act provides that if any property (primarily securities in the present context) is received without consideration or for inadequate consideration, the aggregate FMV [computed as per **Rule 11UA(1)(c)** of the Rules] of such property as exceeds such consideration will be taxable in the hands of the recipient as 'income from other sources'.

Shares subscribed at premium [Section 56(2)(viib) of the Act]

Where an AIF/ VCF subscribes to the shares of an Indian closely held company at a premium and the total consideration for subscription exceeds the FMV of such shares (computed as per **Rule 11UA**), the difference between the total consideration for subscription and FMV of such shares would be considered as income and would be subject to tax in the hands of the issuing company as 'Income from other sources'.

These provisions are not applicable to VCUs receiving consideration for issue of shares from VCFs registered under the VCF Regulations or VCFs registered as Category I AIFs under AIF Regulations.

Conversion of preference shares and debentures

Conversion of preference shares and debentures of a company into equity shares of that company is not regarded as a transfer under **section 47(xb) and 47(x)** of the Act, respectively, of the Act, and therefore, shall not result in capital gains.

The period of holding and the cost of acquisition of equity shares received on conversion shall be the period of holding and cost of acquisition of the preference shares or debentures, as the case may be.

These provisions would not be applicable where the preference shares and debentures are held as stock-in-trade, and accordingly, profit/ loss would have to be computed having regard to the fair value of equity shares received on conversion.

Buy-back of unlisted shares

On the distribution of income by way of buy-back of unlisted shares, in accordance with any law for the time being in force, the portfolio company is liable to pay additional tax at the rate of 20% as per **section 115QA** of the Act. The additional tax is payable on the distributed income computed having regard to the provisions of the said section read with **Rule 40BB** of the Rules.

22 "Quoted share" is defined to mean the share quoted on any recognised stock exchange with regularity from time-to-time, where the quotation of such share is based on current transaction made in the ordinary course of business.

Income arising on account of buy-back of unlisted shares referred to in section 115QA shall be exempt from tax in the hands of the AIF/ VCF/ unit holders under **section 10(34A) of the Act.**

TDS at higher rates

Section 206AA of the Act provides that where a recipient of income does not have a PAN, the tax is required to be deducted by the payer at higher of the following:

- Rates specified in relevant provisions of the ITA; or
- Rates in force; or
- At the rate of 20%.

As per **Rule 37BC** of the Rules, the above shall not apply to non-residents in respect of payments in the nature of interest, royalty, fees for technical services and payment on transfer of capital assets provided the non-residents provide the prescribed information to the payer of such income.

MAT

As per **section 115JB** of the Act, if the tax payable under normal provisions of the Act is less than 18.5% of its 'book profits', the company needs to pay MAT at 18.5% of the book profits to be computed in the prescribed manner.

MAT provisions shall not be applicable to foreign companies where:

- The foreign company is resident of the country with which India has entered into a treaty and it does not have a permanent establishment in India; or
- The foreign company is a resident of a country with which India does not have a treaty and is not required to seek registration under any law for the time being in force relating to companies.

MAT provisions could typically be applicable to resident corporate unit holders in an AIF or VCF, or to an AIF or VCF which is set up as a Company.

AMT

As per **section 115JC** of Act, if the tax payable by a non-corporate entity is less than 18.5% of the adjusted total income, it will be required to pay AMT at 18.5% of the adjusted total income to be computed in the prescribed manner. The provisions of AMT are applicable to non-corporate assessees, which claim certain specified profit and investment linked deductions[23].

While AMT provisions, depending upon the facts, may apply to non-corporate unit holders in an AIF/ VCF, ordinarily, in the absence of claiming any profit or investment linked deductions, AMT provisions should not apply to an AIF (set up as LLP or Trust) or a VCF (set up as a trust).

Income Computation and Disclosure Standards (ICDS)

The Central Government had notified[24] 10 Income Computation and Disclosure Standards (ICDS) to be followed by assessees[25] who follow mercantile system of accounting, for the purpose of computation of income chargeable under the head "Profits and Gains of Business or profession" (PGBP) or "Income from other sources" (IFOS). Thus, where the income of AIFs and VCFs, includes any income under the head PGBP or IFOS, then such AIFs and VCFs (or their unit holders, as the case may be) may be subject to the provisions of ICDS.

23 Any section (other than section 80P) included in Chapter VI-A under the heading "C—Deductions in respect of certain incomes"; or section 10AA; or section 35AD.

24 Notification No. S.O. 3079 (E), dated 27th September 2016, issued under section 145(2) of the Act.

25 Other than an individual or a Hindu Undivided Family who is not required to get his accounts of the previous year audited in accordance with the provisions of section 44AB of the said Act.

Subsequently, *vide* the Finance Act, 2018, various provisions of ICDS are now made part of the Act, by inserting new sections – such as section 36(1)(xviii), 43AA, 43CB, amended section 145A, section 145B of the Act.

Since ICDS are not applicable for the purpose of computation of income chargeable under the head 'Capital Gains', method of accounting for any profit or loss from transfer of securities held as capital assets will be governed by the normal provisions of the Act.

Key ICDS relevant from AIF/ VCF perspective would be –

ICDS I – 'Accounting Policies', which deals with significant accounting policies, including allowability of mark-to-market loss.

ICDS VIII – 'Securities', which deals with valuation of securities which are held as stock-in-trade.

It is pertinent to note that ICDS VIII would not be applicable to securities held by Venture Capital Funds[26].

ICDS IV - Revenue Recognition – Relevant for interest, discounts and dividends on securities.

[XI] Reporting requirements for AIFs and VCFs

Statement of income distribution

As per **Rule 12CB** of the Rules [read with **section 115UB(7)** of the Act], a statement of income (consisting of details of various components of income, etc.) paid or credited by Category I and II AIFs to its unit holder shall be furnished by such AIF:—

- To the unit holders on or before 30th June following the end of the financial year during which the income is paid or credited, in Form 64C; and
- To income-tax authorities on or before 30 November following the financial year during which the income is paid or credited, electronically under digital signature in Form 64D duly verified by an accountant[27].

As per **Rule 12C** of the Rules [read with **section 115U(2)** of the Act] a statement of income (consisting of details of income from investments made in VCU under various heads of income, etc.) paid or credited by VCFs to their unit holders shall be furnished by such VCF: -

- To the unit holders; and
- To income-tax authorities on or before 30 November following the financial year during which the income is paid or credited, electronically under digital signature in Form 64 duly verified by an accountant[28].

Where pass-through taxation is applicable or the AIF/ VCF is required to discharge the taxes on behalf of the unit holders, evaluating whether MAT/ AMT provisions apply to a unit holder or if the unit holders are subject to any other provisions, would be difficult for an AIF/ VCF. Practically, AIFs/ VCFs and their unit holders mutually agree on these aspects (e.g. AIF/ VCF would not take into account applicability of MAT provisions while discharging tax liabilities, etc.).

Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standard (CRS)

To enable financial institutions in India to comply with FATCA and CRS, the Act requires a 'Reporting Financial Institution' (RFI) to furnish

26 "Venture Capital Funds" shall have the meaning given under section 10(23FB) of the Act, which covers VCF/VCC registered under the VCF Regulations or VCF registered as sub-category of Category I AIF under the AIF Regulations.

27 As defined in Explanation to sub-section (2) of section 288 of the Act.

28 Section 285BA of the Act read with Rule 114F – 114H of the Rules.

a statement of reportable accounts maintained by it. Further, it also provides that the Central Government may, by rules, specify the:

- the RFI to be registered with the prescribed income-tax authority;
- nature of information and the manner in which such information shall be maintained by the RFI; and
- the due diligence to be carried out by the RFI for the purpose of identification of any reportable accounts.

The rules define RFI to mean a financial institution which is not a non-reporting financial institution. A non-reporting financial institution has been defined to mean any financial institution that includes an exempt collective investment vehicle and a financial institution with a local client base, subject to specified conditions.

Where an AIF qualifies as either an 'exempt collective investment vehicle' or a 'financial institution with a local client base', it would be regarded as a non-reporting financial institution and hence, should not be required to comply with FATCA reporting requirements.

Where an AIF qualifies as an RFI (e.g. having non-resident unit holders), it would need to comply with FATCA reporting requirements under the Act by filing a 'statement of reportable account' in Form 61B for the 'reportable account' maintained by it for every calendar year by 31 May of the following year.

[XII] Taxation in the hands of the manager

The manager shall be taxable on the management fees at 30%/ 25% on its total income computed as per the provision of the Act.

[XIII] Taxation of trusteeship fees in the hands of the trustee(s)

The trustee(s) shall be taxable on the trusteeship fees at 30%/ 25% on its total income computed as per the provision of theAct.

Note: Tax rates mentioned in this Article are exclusive of applicable surcharge, health and education cess.

Annexure 1

Key differences in taxation provisions applicable to Category I and II AIFs, and VCFs

Sr. No.	Provisions	Category I and II AIF	VCF
1	Relevant Sections	10(23FBA), 10(23FBB), 115UB	10(23FB), 115U
2	Exempt income in the hands of AIF/ VCF	Any income other than income chargeable under the head "Profits and Gains of Business or Profession"	Any income from investments in VCUs
3	Taxable Income in the hands of AIF/ VCF	Income chargeable under the head "Profits and Gains of Business or profession"	Income other than income from investments in VCUs – would be taxable depending upon the legal form of the VCF. Trust taxation provisions will apply in the case of a trust VCF
4	Taxation of Business Income	Taxable in the hands of the AIF and exempt in the hands of unit holders	Please refer to Sr. Nos. 2 and 3
5	Tax rates prescribed for taxation in the hands of AIF	Prescribed	Not prescribed
6	Availability of unabsorbed losses to unit holders	Not available	Not specifically dealt with. Arguably, available.
7	TDS on distribution by AIFs/ VCFs to unit holders	Applicable	Not Applicable

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CA Divyesh Lapsiwala & CA Amit Bothra

Alternative Investment Funds and Venture Capital Funds Indirect Tax – Key Provisions

Background

Alternative Investment Funds (AIFs) and Venture Capital Funds (VCFs) are investment vehicles established to pool in funds for investing in real estate, private equity, managed futures, commodities and derivatives contracts and hedge-funds with a pre-determined objective. An AIF is a non-conventional asset unlike the typical investments in stocks, bonds, cash, etc.

AIF and VCF collect funds from domestic and overseas investors and invest the same in start-ups or small & medium setups that have high growth potential. AIFs/ VCFs are primarily aimed at high net worth individuals (HNIs) with minimum individual investment of INR 10 million as per the Securities and Exchange Board of India (SEBI) norms.

The regulatory aspects have been discussed in detail in the previous chapters. In this segment, we have sought to highlight the key implications on AIFs from an indirect tax perspective.

Some of the key features of the AIF structure relevant to evaluate indirect tax implications are:

General mechanism

– AIFs are generally set up as a company / trust or limited liability partnership while VCFs are typically set up as a company or a trust for pooling funds for investments from domestic and offshore investors

– Units are assigned to the participating and eligible individual members based on amounts invested

– Sponsor of the AIF/ VCF incurs costs in relation to setting up of the fund, and recovers such expenses from the fund to the extent approved/ allowed in the investment terms

- Investment managers are appointed to provide investment management services to the AIF, who are paid agreed fees

– Trustee of the trusts provide trusteeship services to the AIF

Allotment of units

Basis the capital commitment to the AIF/ VCF for investment purpose, the AIF/ VCFs allocate units to investors.

The question that arises from a GST perspective is that whether the activity of allotment of units be considered as 'supply' for the purpose of levy of GST.

For an activity to be considered as taxable, it is essential that it qualifies as a 'supply' under GST. For a supply between unrelated persons, 'consideration' is a key element. In case of allotment of units, the investors merely make the capital commitment and accept the terms of the investment plan for a consideration in the form of interest and capital gains.

The underlying activity in this case is investment in the fund by the investors. The units are a manner of affirming the quantum of investment by the investor akin to allotment of mutual fund units or share certificates. Such activity being in the nature of investment should not be liable to GST.

Furthermore, the definition of 'goods' and 'services' exclude transaction in securities. Given this issuance of units to investors should not be regarded as a supply under GST provisions.

Vesting of units

The units are vested over the stipulated period of the Investment Plan. During this period the fund would invest in desired investment schemes and earn returns from such investment.

This activity of vesting as per investment plan is comparable to investments (as discussed above) and therefore not liable to GST.

Income earned by the AIF/ VCF

Income of AIF could be in the nature of interest, dividend, profit on sale of securities, etc.

All such incomes do not attract levy of GST. These are all return on investments, which is not regarded as a 'supply' transaction. The AIF is only an investment vehicle and therefore does not perform any activity that should be liable to GST.

Management fees paid by AIFs/VCFs

Fund management services are taxable supplies under the present GST laws attracting a tax rate of 18%.

The taxability of the service in India is determined basis the location of the service recipient ie the AIF/ VCF. Thus, if services are provided to an onshore fund, GST should apply. If services are provided to an offshore fund, no GST should apply as the services can be claimed as 'zero-rated' exports.

In case of overseas fund managers providing services to an onshore AIF/VCF, GST is applicable at the rate of 18% under the reverse charge mechanism as an import of service taxable in the hands of the onshore AIF/VCF.

Ability of AIF/ VCF to avail input tax credit

As discussed earlier, all incomes earned by AIF/ VCF are generally not liable to GST. Therefore, such entities do not have the ability to avail input tax credit of the GST charged by Investment Managers.

The investor in the AIF also cannot claim credit of the tax charged by the manager. This is based on the principle that the manager is appointed by the Fund and not by the investor. The manager has privity of contract to provide services only with the AIF/ VCF and not with the investor. Therefore, despite the fact that some of the investors could arguably take input credit if the manager had provided services directly to them, such mechanism is not possible in the AIF/ VCF structure.

This means that GST would impact two situations directly:

– Onshore manager providing services to an onshore fund

– Offshore manager providing services to an onshore fund

If an onshore manager provides services to an offshore fund, zero rating provisions would permit eliminate impact of tax on the fees. It would be pertinent to examine whether in such case, a reverse charge GST/ VAT applies in the country in which such offshore fund is located.

The above tax outcome is resulting in some level of distortion between the impacts on onshore fund structure versus offshore funds structure.

We understand that Indian Private Equity and Venture Capital Association, which represents

VCFs and Private Equity firms in India, have filed a formal representation with the Finance Ministry seeking a reduction in the GST rate from the present 18% to 5% on the management fees collected from onshore funds to make the onshore funds a more viable option for investors.

Sponsor's expense recovery

The sponsor of the fund typically incurs expenses in relation to setting up costs, and is allowed a certain percentage of the contributions made as fees for performing such activity. While the purpose is to reimburse set up expenses, amount payable is linked to total collections in the fund.

Such recovery is likely to qualify as a 'supply' under the GST regulations. It will be difficult to claim that the payment made to the sponsor is in the nature of reimbursement of expenses given that:

– Payment is not linked to actual expenses incurred, it is a percentage of collections

– Pure agent conditions under the regulation are unlikely to be satisfied as there is no prior authorization to incur the expenses (from the investor to the sponsor), and

– It will be difficult to argue that the sponsor did not receive any benefit from the benefit from the services received from the underlying service providers (whose cost is being claimed as a reimbursement).

Furthermore, similar to investment manager's fees, investors would not be able to claim credit of the tax charged by the sponsor as the services are provided to the fund and not directly to the investor.

Distribution of income by the AIF/ VCF

After the vesting period, the income accrued on the units is distributed to the investors in the form of dividend or interest. Such dividend or interest is not taxable (on account of exemption) in the hands of the investor under the present GST laws.

Credit leakage in the hands of investors

Interest income from investments/ securities are exempt from GST on account of the exemption granted to interest on loans, deposits and advances. Here, the income earned by the Indian investors who are registered under the GST provisions from such investment are likely to trigger reversal of common credits to the extent of the turnover of such exempt income as compared to the total turnover of the investors.

This is based on a specific provision under the GST regulations suggesting that "transactions in securities" is an exempt supply for the purposes of determining eligible input tax credit claims. While one could argue whether investment in AIF and return thereto can qualify as a transactions triggering reversals, a specific provision in the regulations will certainly trigger controversy.

In summary

With appropriate taxation schemes and incentives, AIFs/VCFs can be lured to establish funds in India itself, rather than exploring offshore locations. This will, in turn, have significant collateral benefits for the Indian economy.

When the fund is set up in India, the foreign capital investments are, in a sense, 'earmarked' and 'locked' for the tenure of the AIF/VCF, which generally spreads for few years.

Such long-term commitments and increased fund management services could aid in creating a 'manage in India' financial services ecosystem, nurturing talent pool in the country.

Overall, the growth of fund management activities in India, elimination of locational discrimination of funds and providing tax incentives or rebates will provide a competitive edge to the Indian AIFs/ VCFs in the global scenario.

We hope the Government continues with its visionary approach towards encouraging private equity flows into India through this proposed GST reform.

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CA Shefali Goradia & CA Ankush Bhutra[1]

Securitisation Trusts – An Overview

Post World War II, lending institutions could not satiate the ever growing demand for housing credit. This business opportunity prompted lending institutions to scout for new avenues for mortgage funding. Investment bankers created a vehicle that would hold isolated pools of mortgage loans with segmented credit risk and cash flows. Such vehicle issued securities to investors to raise funds for acquiring the pool of mortgage loans from the lending institutions, thus freeing up capital for the subsequent round of housing credit. This became a model which was scalable across various other pools of loans and thus securitisation was born.

This article will discuss various aspects of securitisation, associated Indian regulatory and tax landscape and the future outlook.

What is Securitisation?

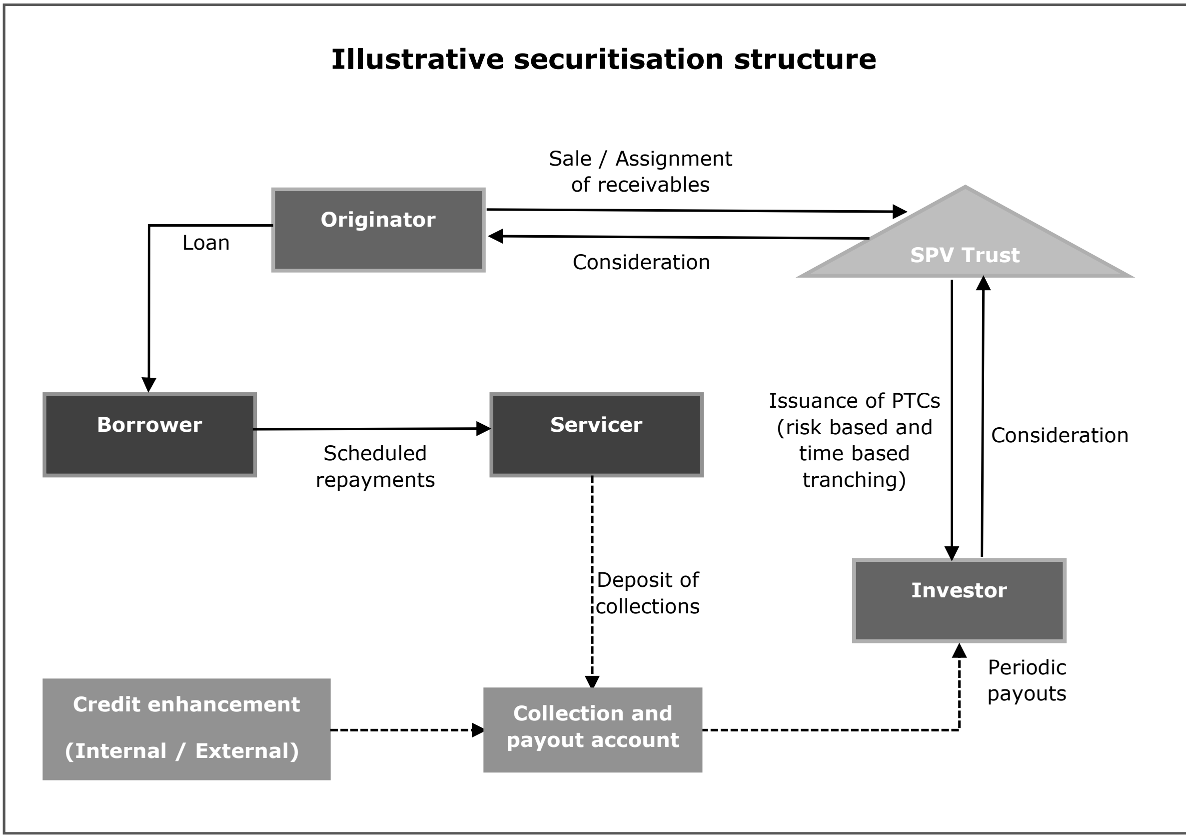
Securitisation is a process to convert pools of loans or receivables into marketable securities. Banks and financial institutions, such as Non-Banking Finance Companies **(NBFCs)** and Housing Finance Companies **(HFCs),** securitise their loans or receivable portfolios by transferring the right to receive future payments from borrowers to investors against immediate payment. Cash flows from borrowers are sold to investors in the form of marketable securities. Securitisation helps in creating liquidity for lending institutions as it releases capital stuck in existing loans.

Securitisation first began in the United States of America **(US)** with structured financing of mortgage loans. In February 1970, the US Department of Housing and Urban Development implemented the transaction using a mortgage-backed security. Europe experienced securitisation deals in the late 1980s, while in India, the first widely reported securitisation deal was consummated in 1991 between Citibank and GIC Mutual Fund for INR 160 million. Citibank securitised auto loans with GIC Mutual Fund subscribing to the securities issued.

Securitisation in India mainly takes the form of a Trust structure, wherein the underlying financial assets are sold to a Trust managed by a professional trustee. The Trust issues securities in the form of Pass-Through Certificates **(PTCs)** or Security Receipts **(SRs)** to raise funds from

1 The authors wish to thank Jimit Shah and Prachi Dubey for their inputs.

investors. Investors holding the PTCs/ SRs are entitled to beneficial interest in the underlying financial assets.



The parties involved in the securitisation process and their respective roles are briefly stated below:

1. **Originator –** The original lender and seller of receivables. In India, this is typically a bank, NBFC, or a HFC (henceforth collectively referred to as 'financial institutions' or '**FIs**').

2. **Borrower –** The counterparty to whom the originator makes a loan.

3. **Issuer (Special Purpose Vehicle - SPV) –** The entity that issues marketable securities (to which investors subscribe) and ensures that transactions are executed on specific terms. In India, the SPV is typically set up as a Trust.

4. **Arranger –** Investment banks responsible for structuring the securities. They co-ordinate with other parties (such as investors, rating agencies, and legal counsel) to execute the transaction successfully.

5. **Investor –** The purchaser of securities i.e., PTCs or SRs. In India, investors are typically banks, insurance companies, mutual funds and Foreign Portfolio Investors (**FPIs**).

6. **Credit enhancement provider –** Credit enhancement (**CE**) is a facility that covers any shortfall in pool collections in relation to investor payouts. It can be classified into two forms

– external and internal. External CE refers to enhancement modes provided over and above the cash flows of the underlying loan portfolio and is provided by way of cash collateral, subordination, guarantees and corporate undertakings. Internal CE is provided by excess spread and over collateralisation. Typically the originator provides CE as a facility that covers any shortfall in pool collections in relation to investor payouts. The enhancement can also be provided by a third party for a fee.

7. **Rating agency** – These agencies analyze risks associated with each transaction, stipulate CEs commensurate with the ratings of the securities, monitor the performance of the transactions until maturity, and take appropriate rating actions.

8. **Servicer** – The entity that collects periodic installments due from individual borrowers, makes payouts to investors, follows up on delinquent borrowers, and furnishes periodic information about pool performance to the rating agency, for a fee. In India, the originator typically acts as the servicer.

9. **Risk or credit tranching** – It is a form of cash-flow tranching prevalent in India. It involves the creation of instruments with different risk profiles. Senior PTCs are accorded the first priority on cash flows and are ranked according to credit quality (from highest to lowest) and degree of associated risk (from lowest to highest). Subordinate PTCs support payments of senior tranches, and carry lower credit ratings.

10. **Time tranching** – It involves the creation of securities with different maturities to cater to investors with varying investment horizons.

11. **Excess spread** – It is a built-in margin of safety that protects the securitised asset pool from losses. The issuer structures the pool so that the yield generated from the payments associated with the assets in the pool, exceeds the payments to investors as well as other expenses, such as insurance premiums, servicing costs.

Following three types of securitised instruments are prevalent in the Indian market:

1. Asset-backed securities (**ABSs**) are instruments backed by receivables from financial assets, such as vehicle loans, personal loans and other consumer loans (but excluding housing loans).

2. Collateral debt securities are instruments backed by various types of debt, including corporate loans or bonds known as collateralized debt obligation (**CDO**).

3. Mortgage-backed securities (**MBSs**) are instruments backed by receivables from housing loans.

Drivers of securitisation in India

1. **Priority sector lending (PSL) targets** – Banks are mandated by Reserve Bank of India (RBI) to meet prescribed minimum exposure in identified sectors such as agriculture, MSME (micro small and medium enterprises), education, etc. Banks meet the shortfall in their PSL targets by purchasing eligible loan portfolios from NBFCs / PSL rich banks through securitisation.

2. **Off-balance sheet financing** – Securitisation allows originating FIs to free up their capital by shifting out the loan assets from their books. The regulatory capital released (as per applicable capital adequacy norms) can be used for the next round of lending, thus improving return on capital and investment ratios.

3. **Diversification of risk** – Securitisation facilitates creation of stratified securities

from a timing, credit and liquidity perspective thus catering to investors with varying risk appetite. This leads to creation of multiple investor classes, thereby deepening the financial market. For instance, mutual funds take higher risks compared to insurance companies. However, pension funds are most conservative, and are interested in low-risk, AAA-rated instruments.

4. **Asset-liability management (ALM)** – Securitisation provides flexibility in structuring the timing of cash flows of each security tranche thereby assisting in ALM. Also, securitisation leads to transfer of funding-mismatch risk to entities that are more capable of bearing the risk (such as pension funds and insurance funds with long-term liabilities), which could be matched with long-term securitised commercial paper. Also, securitisation allows a financial institution to improve its asset–liability maturity profile by replacing long-term assets with cash.

5. Inorganic growth – Securitisation helps financial institutions to acquire loan portfolios which they could not create on their loan books thereby generating inorganic growth.

Indian Regulatory landscape

Securitisation has been in practice in India since the early 1990s. In its primitive form (which is also prevalent currently as direct assignment), securitisation did not lead to creation of a security as it was executed in the form of bilateral acquisition of loan portfolios between FIs. As there was no regulatory regime in place till the early 2000s for FIs, such institutions had to back securitisation transactions extensively with CEs. At the same time, such institutions were able to enjoy complete relief from maintaining regulatory capital as the loan portfolio moved out of their books. Also, in the absence of any specific accounting rules, FIs booked entire gains on transfer of loan portfolio at the time of sale.

Amendment in NHB Act

With a view to encourage mortgage backed securitisation in India, in 2000, the central Government amended the NHB Act[2]. NHB was entrusted to undertake securitisation of residential mortgages originated by HFCs / banks and ensure the development of secondary market for residential mortgages.

NHB sets up the securitisation trust and acts as the trustee to the transactions. The trust acquires the eligible housing loan portfolios from lenders and the securitisation process follows as illustrated above.

Enactment of law for managing stress assets

To address the problem of mounting non-performing loans **(NPAs)** and equip the FIs (primarily banks) with a legal framework for speedy recovery of defaulting loans, the central Government enacted the SARFAESI Act[3]. Such enactment was based on the recommendations of the Narasimham Committee I and II and the Andhyarujina Committee constituted for the purpose of examining banking sector reforms. These committees, *inter alia*, suggested empowering banks and eligible financial institutions to take possession of the securities (attached to the loans) and to sell them without any intervention of courts. While the name includes the term 'securitisation', SARFAESI Act, in essence, has been relevant for registration and enforcement of security interests and creation and operation of asset reconstruction companies **(ARCs)** which deal in portfolio of NPAs of FIs. Commercially, securitisation of standard loan portfolios of FIs is implemented under prescribed guidelines of the RBI (discussed

2 National Housing Bank Act, 1987.

3 Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

below) and not under SARFAESI Act. SARFAESI Act, along with RBI ARC Guidelines[4], create an enabling framework through ARCs for securitisation of NPAs. The RBI ARC Guidelines provide for registration of ARCs, measures of asset reconstruction, prudential norms and associated matters.

Under SARFAESI Act, only qualified buyers (QBs) are permitted to invest in SRs issued by ARCs. To begin with, QBs comprised of banks, insurance companies, etc. The QB ambit was widened in 2008 and 2012 to include specified NBFCs and Alternative Investment Funds (AIFs) registered with Securities and Exchange Board of India (SEBI), respectively.

In August 2016, the Central Government accepted a long standing demand by notifying 196 NBFCs (with asset size equal to or more than INR 500 crores as per last audited balance sheet) as eligible financial institutions to benefit from the provisions of SARFAESI Act. Such NBFCs can enforce security interest under the provisions of sections 13 to 19 of SARFAESI Act provided such security interest has been obtained for securing repayment of secured debt with principal amount of INR 1 Crore or above.

RBI securitisation guidelines

Till 2006, the securitisation volumes of standard loan portfolios touched new peaks every year with evolving transaction structures with respect to risk tranching and time tranching. In 2006, this party was cut short as RBI introduced the Guidelines on Securitisation of Standard Assets **(2006 Guidelines)** to regulate securitisation by FIs. These guidelines, *inter alia*, provided for the following:

1. For enabling the transferred assets to be removed from the balance sheet of the originating FI, the isolation of assets or 'true sale' (i.e. legal separation) from the originator to the SPV is an essential prerequisite. Such sale should be on arm's length basis.
2. There shall be no obligation on the originating FI to repurchase or fund the repayment of the asset or any part of it or substitute assets held by SPV or provide additional assets to the SPV at any time except those arising out of clean up calls or breach of warranties or representations provided.
3. The SPV should be independent of the originating FI. The originating FI shall not support the losses of the SPV except under the facilities explicitly permitted.
4. Capital requirements for first loss, second loss, liquidity and underwriting facilities provided for originating FI.
5. The originating FI should not be under any obligation to purchase the securities issued by the SPV and should not subscribe to their primary issue. The originating FI may, however, purchase at market price only senior securities issued by the SPV if these are at least 'investment grade', for investment purposes. Such purchase, along with the securities that may devolve on account of underwriting commitments, should not exceed 10% of the original amount of the issue.
6. PTCs issued by the SPV should be compulsorily rated by a SEBI-registered rating agency.
7. Loss arising on securitisation should be recognised by the originating FI in the year of sale while profit, if any, should be amortised over the life of the PTCs issued by the SPV.

Surprisingly, RBI did not cover direct assignment in the ambit of 2006 Guidelines. Naturally, FIs resorted to direct assignment and securitisation

4 Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003.

moved back to its initial form till 2012 when RBI corrected its stance. In May and August, 2012, RBI issued revised guidelines for securitisation of standard assets for banks (including NHB) and NBFCs respectively (2012 Guidelines). These guidelines also prescribed norms for direct assignment. The mandate of 2012 Guidelines was to prevent unhealthy practices surrounding securitisation – origination of loans for the sole purpose of securitisation, to align the interest of the originating FI with that of the investors and to redistribute credit risk to a wide spectrum of investors. In addition to the 2006 Guidelines, the 2012 Guidelines, *inter alia*, provided for the following:

1. Minimum holding period: Loans which have been seasoned for prescribed time in the books of originating FI could only be securitised to ensure appropriate due diligence by such FI.
2. Minimum retention requirement: This was introduced to ensure that the originating FI has a continuing stake in the securitised assets for the entire life of the securitisation process. This was carved out as an exception to the true sale requirement as discussed above.
3. Transactions not eligible for securitisation: This included revolving credit facilities (credit card receivables), assets purchased from other entities, securitisation exposures and loans with bullet repayment of both principal and interest.

While both 2006 and 2012 Guidelines discussed CE, they did not address the need to reset CE during the life of the securitisation transaction. In July 2013 and March 2014, the RBI issued guidelines governing reset of CE for banks (including NHB) and NBFCs respectively. Release of CE was permitted only with respect to external CE subject to stipulated checks, delinquency triggers and a reserve floor. Release of CE over the tenure of a securitisation transaction reduced the regulatory capital requirements.

Foreign investment and listing framework

In November 2005, foreign investment was permitted in ARCs only under the foreign direct investment (FDI) route up to 49%, subject to Government approval. FPIs were permitted to invest up to 49% of each tranche of SRs subject to a per FPI limit of 10% of the issue size. Over the years, the FDI regime has been liberalised with 100% foreign investment permitted in ARCs under automatic route. Also, FPIs are permitted to hold equity stake in ARCs with a limit of 10% of total paid-up capital per FPI. Further, FPIs can now invest up to 100% of each tranche of SRs.

In November 2005, with the objective to create a trading market for securitisation instruments, the Central Government amended the definition of the term 'securities' under SCRA[5] to include securitisation instruments. A new sub clause (i.e.) was added to clause (h) of section 2 of the SCRA which currently reads as under:

'Any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.'

This inclusion paved the way for listing of securitisation instruments issued under all permissible forms of securitisation. Prior to such inclusion, the definition of the term 'securities' included only SRs issued under the SARFAESI Act.

In May 2008, SEBI released the enabling framework for public offer of securitised debt instruments[6]. This regime also permits listing of such instruments which have been privately

5 Securities Contracts (Regulation) Act, 1956.

6 SEBI (Public Offer and Listing of Securitised debt instruments) Regulations, 2008.

placed subject to specified disclosures. In spite of growing volumes of securitisation deals over the years, listing of securitised debt instrument has been scarce. This can be primarily attributed to lack of any motivation to list such instruments as most of the deals are privately placed by the FIs with institutional investors. Also, considering the complex nature of the instruments and largely fixed returns, HNIs and retail investors are not expected to be the target investors. In January 2013, IFMR Capital listed the first securitised debt instrument in the form of senior securities of IFMR Capital MosecTM XXII on Bombay Stock Exchange **(BSE)**[7].

In November 2016, to promote growth of Indian debt market, RBI and SEBI permitted FPIs to invest in unlisted debt securities and securitised debt instruments issued under permitted forms of securitisation in India. FPI investment in securitised debt instruments and SRs issued by ARCs, should be within the applicable corporate debt limit. Also, such FPI investment is not required to comply with minimum residual maturity requirements.

Indian taxation framework – synopsis
Income-tax

Prior to Finance Act 2013, taxability of income arising in the hands of the stakeholders associated with securitisation, was governed by general principles of trust taxation. Section 161 of the IT Act[8] provides that in case of a Trust if its income consists of or includes profits and gains from business, then income of such Trust shall be taxed at the maximum marginal rate in the hands of Trust. Lack of special dispensation in respect of taxation for SPVs set up in the form of a Trust to undertake securitisation activities was impacting overall tax efficiency. The taxation at the level of Trust due to existing provisions was considered to be restrictive particularly where the investors in the Trust were persons who are exempt from taxation under the provisions of IT Act, such as mutual funds and FPIs.

In order to facilitate the securitisation process, Finance Act 2013, introduced a special taxation regime in respect of taxation of income of securitisation entities, set up as a Trust, from the activity of securitisation. Section 10 of the IT Act was amended to introduce clause (23DA) which exempts the income of a securitisation Trust arising from the activity of securitisation. On the lines of distribution tax levied in the case of mutual funds, securitisation trusts were made liable to pay income-tax on income distributed to its investors (25% in case of distribution made to individuals and HUFs and 30% in other cases). The distributed income received by investors was exempted from tax under the newly-introduced clause (35A) to section 10 of the IT Act.

Such taxation regime suffered from the following lacunae:

- Trusts set up by ARCs under the SARFAESI Act were not covered;
- Final levy in the form of distribution tax is tax inefficient for investors. Further, the non-resident and resident investors were unable to obtain benefits of their specific tax status; and
- Disallowance of expenditure in respect of exempt income received from securitisation trust increased the effective rate of taxation.

The Finance Act 2016 further rationalized the tax regime for securitisation trust and its investors. The income accrued or received from the securitisation trust is now taxable in the hands of investors in the same manner and to the same extent as it would have been taxed had investors invested directly in the underlying assets and not through the SPV. Distribution tax has been replaced with withholding tax – securitisation trust is required to deduct tax at source at the

7 Book 'Securitisation, Asset Reconstruction and Enforcement of Security Interests' Fourth Edition 2013, by Vinod Kothari.

8 Income-tax Act, 1961.

time of credit or payment, whichever is earlier, at the rate of 25% (for individuals and HUFs) or 30% (for other resident investors). In case of non-resident investors, tax withholding is done at rates in force thereby providing relief as per special tax status or under tax treaty, if applicable. Also, the CBDT *vide* Notification No. 46 / 2016 dated June 17, 2017 has exempted all payments made to a securitisation trust from withholding tax thereby improving cash flows. The aforementioned special tax regime has been extended to cover securitisation trusts referred to in RBI securitisation regulations, SARFAESI Act, and SEBI regulations.

The securitisation trust needs to provide a break-up regarding nature and proportion of its income to the prescribed income-tax authority and the investors under Rule 12CC of the Income-tax Rules, 1962 in Forms 64E and 64F respectively.

Goods and Services Tax (GST)

Till recently, there was lack of clarity on applicability of GST to securitisation transactions. The GST Council came out with a set of frequently asked questions (**FAQs**) on financial services in June 2018. It has now been made clear that securitised assets are in the nature of securities and hence not liable to GST. However, if service charges or service fees or documentation fees or broking charges or such similar fees or charges are levied, the same will be a consideration for provision of services related to securitisation and thus attract GST. The FAQs however, do not clarify if GST will be charged on excess spread.

Challenges

Priority sector lending certificates (PSLCs)[9]

In April 2016, the RBI issued a circular in respect of trading of PSLCs to rationalise the achievement of PSL target by the banking system. As meeting PSL targets is one of the key drivers of securitisation market in India, RBI introduced the PSLC trading mechanism to enable PSL rich banks to sell PSL credits to PSL deficient banks. Under this mechanism, banks trade off their PSL positions (positive and negative) without any actual movement of underlying PSL loan portfolios and associated cash flows and risks. It is expected that PSLC regime will dent the securitisation volumes amongst banks. NBFCs and HFCs are not permitted to issue PSLCs.

Incidence of stamp duty[10]

Since securitisation transactions involve assignment of the underlying receivables to the SPV for the benefit of the investors, as well as the transfer of the underlying collateral, if any, these transactions are liable for the payment of stamp duty and document registration fee. Imposed by the state under the federal structure of India, the rate of stamp duty varies from 3% to as high as 14%. Securitised loan pools with no underlying immovable assets are liable to stamp duty only on assignment of receivables, and for a registration fee, whereas loan pools with underlying real-estate assets, such as power projects, are liable to stamp duty on the assignment of the immovable property as well.

The incidence of stamp duty for securitised papers is not significant for loan pools with no underlying immovable assets, as five major states have recognized securitisation as a separate financial transaction, and have thus reduced the stamp duty rate to 0.1% of the book value of the loan, capped at INR 1,00,000.

Since 2016, ARCs have been exempted from levy of (a) stamp duty, in case of assignment of financial assets in favour of ARCs and (b) registration requirement, in respect of transfer of underlying security interests which comprise of immovable property.

9 Report 'State of Indian Securitization Market, 2016' by Vinod Kothari Consultants Pvt. Ltd.

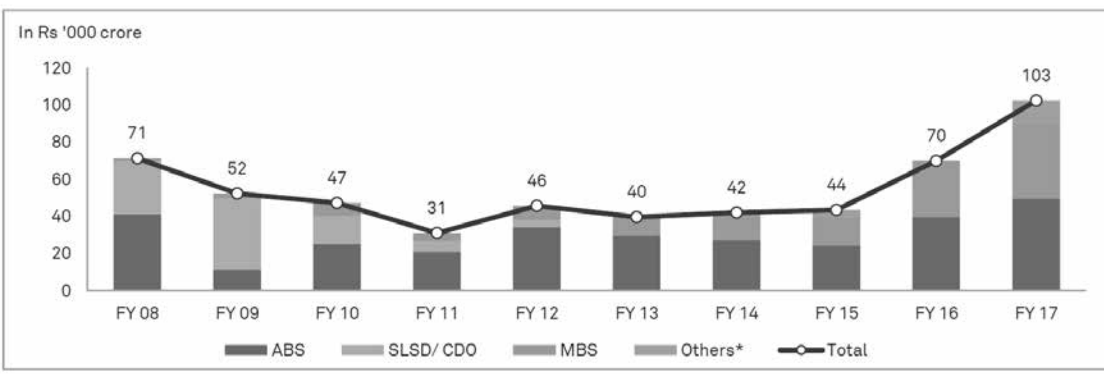
10 Report 'Securitization in India – Managing Capital Constraints and Creating Liquidity to Fund Infrastructure Assets' by Asian Development Bank. Also, inputs taken from online publication of International Comparative Legal Guides - 'Securitization 2018' – authored by Shabnum Kajiji and Nihas Basheer, Wadia Ghandy & Co.

Future outlook

Securitisation is believed to be one of the key factors which led to the meltdown in global financial markets in 2008. Reckless use of fancy structures eroded investor confidence. Regulators and financial institutions soon realised that the revival of the securitisation market was essential for the revival of the economies globally. To this end and intent, several regulations were recast to restart the securitisation market globally, including the Dodd Frank Act[11]. While the US continues to be the largest securitisation market, securitisation volumes in Europe continue to be low.

As per S&P Global Ratings, with improving economic fortunes in the US and Europe, global structured finance issuance will play a larger role in financing the world economy. Approximately $1 trillion of global structured finance issuance is expected in 2018. This continues the strong growth experienced in 2017, when global issuance increased by 39% from 2016 to $930 billion, U.S. equivalent. The growth has been sustained by expectations of a 3% year-over-year (y/y) increase in U.S. GDP, combined with expectations of GDP growth of 2% or more in Canada and most of Europe, as well as continued growth in the Asia-Pacific (APAC) region.

In India, securitisation volumes have soared across various securitisation instruments as captured below[12].



Source: CRISIL estimates *SLSD = Single loan sell down*

While the adverse impact of demonetization and GST implementation on performance of underlying loan portfolio is close to its end, advent of PSLCs is expected to dampen the securitisation volumes for PSL portfolios. Foreign banks with less than 20 branches, who have incremental PSL targets, are likely to embrace the PSLC option. However, healthy demand for PTCs backed by non-priority sector loans (due to their higher yields) should rebound from treasuries of FIs, insurance companies and mutual funds.

With income-tax pass-through status, non-levy of GST, FPI investments and a supportive regulatory framework, the Indian securitisation market should scale greater heights.

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11 Dodd-Frank Wall Street Reform and Consumer Protection Act, 2010.

12 Report 'Securitisation Market Overview 20160-17' by CRISIL.



CA Amit Kabra, CA Amit Lahoti, and CA Anshul Arora

Securitisation Trusts – Accounting Aspects

Securitisation is a process by which financial assets such as loan receivables, mortgage backed receivables, credit card receivables, hire-purchase debtors, lease-rent receivables, trade debtors, etc., are transformed into marketable securities. Securitisation enables the originator or owner of such financial assets to monetise them by selling them to a third party for an immediate realisation of an agreed consideration. The two key stages of the securitisation process are:

i. Sale of a single asset or a pool of assets by the owner **(Originator)** to Special Purpose Vehicle **(SPV)** constituted as a trust, in return for an immediate cash payment and/or other consideration;

ii. Repackaging and selling the security interests representing claims on incoming cash flows from the asset or pool of assets to third party investors by issuance of tradable debt securities known as pass through certificates **(PTCs)**.

Accounting aspects are critical to any securitisation transaction, since one of the main objectives of securitisation is for the Originator to put assets off the balance sheet and release regulatory capital. Unlike other business transactions accounting for securitisation impacts the viability of the transaction because if the main objective is not achieved it will constrain the Originator from doing further new business.

The development and growth of securitisation industry is significantly impacted by the accounting guidelines for such transactions.

There are different accounting aspects relating to a securitisation trust from the point of view of the seller of assets (Originator), the trust itself (SPV) and the investors who purchase the PTCs. We will first examine the accounting aspect from the point of view of the Originator as these tend to be more complex and there are several regulatory requirements which at times require significant judgment to be applied. Also, the transaction structure is primarily designed to achieve a certain accounting outcome for the Originator i.e., derecognition of the assets from its balance sheet.

Under Indian GAAP (IGAAP), accounting for securitisation in the books of the

Originator was governed by the guidance note on securitisation issued by the Institute of Chartered Accountants of India (ICAI). This guidance note, which was issued way back in 2003, was to stand withdrawn upon notification of the Accounting Standards (AS) 30 and 31. While the ICAI guidance note provided the accounting framework, the key principles governing the structuring of securitization transactions in India were laid down in the Reserve Bank of India (RBI) Guidelines on Securitisation of Standard Assets *vide* circular no. DBOD.NO.BP.BC.60 / 21.04.048/2005-06 dated February 1, 2006 read with Revisions to the Guidelines on Securitisation Transactions *vide* Circular No. DNBS. PD. No. 301/3.10.01/2012-13 dated August 21, 2012. These guidelines inter alia influence the accounting for securitisation and even override the guidance note and general accounting conventions in certain aspects.

It is also important to note that the accounting for securitisation is different under the Indian GAAP as compared to the IFRS convergent Indian Accounting Standards (Ind-AS) which will become applicable for financial enterprises such as NBFCs from financial year 2018-19 onwards and for Banks from financial year 2019-20 onwards. We have separately analysed the accounting aspects for the parties involved from Ind-AS point of view and highlighted certain areas which require significant estimation and judgment.

INDIAN GAAP ACCOUNTING

Accounting considerations for the Originator

- **De-recognition:** The first important accounting question that an Originator has to determine is whether the assets that they have transferred to a securitisation trust should be removed from their balance sheet. Under the accounting principles a securitised asset should be de-recognised from the balance sheet of the Originator if the Originator loses control of the contractual rights that comprise the securitised asset. The exact same principle is enshrined under the RBI guidelines also which state that the transferred assets would be derecognised from the balance sheet of the originator only when the assets are transferred to the SPV by the originator is in full compliance with all the conditions of "true sale" (as defined in above stated RBI circulars). These "true sale" conditions require an immediate legal separation of the assets from the seller, transfer of all risks/rewards and risks/obligations, no beneficial interest remaining with the seller, buyer having unfettered right to pledge, sell, transfer or dispose the assets. A legal opinion from a legal counsel is required to confirm that all rights and obligations related to assets have been transferred and the creditors of the seller do not have any right in any way against these assets. In the event of the transferred assets not meeting the "true-sale" criteria the assets would be deemed to be on the balance sheet of the originator and the sale consideration received shall be treated as a borrowing.

- **Partial de-recognition:** An Originator may transfer only a part of the financial asset in a securitisation transaction instead of transferring the complete asset. Such transfer may occur in two ways:

  o Transferring a proportionate share of the asset wherein the Originator may transfer a proportionate share of loan (including right to receive both interest and principal), in such a way that all future cash flows, profit/loss arising on loan will be shared by the Originator and the SPV in fixed proportions.

- o Transferring a part of a financial asset arises where the asset comprises the rights to two or more benefit streams, and the Originator transfers one or more of such benefit streams while retaining the others. For example, the Originator may securitise the Principal Strip of the loan while retaining the Interest Strip.

If the Originator transfers a part of a financial asset while retaining the other part, the part of the original asset which meets the de-recognition criterion as mentioned above should be de-recognised whereas the remaining part should continue to be recognised in the books.

- **Gain/ loss/ income on securitisation:** Once the Originator has met the criteria set out in accounting guidelines for 'true sale', the next important accounting area is how to record any gain/loss or income on securitisation. The gain or income on securitisation mainly comprises the "excess interest spread" or "interest strip", which basically represents a part of the interest received on the underlying financial assets. For example, an Originator is securitizing a loan portfolio of retail loans which pay interest at 15% and has struck a deal with investors whereby they will only receive 12% interest and the remaining 3% interest will paid back to the Originator. This remaining 3% interest represents the gain or income on securitization. A securitisation transaction can be done "at par" or "at premium". In an "at par" transaction, the Originator usually receives consideration equal to the face value of the loan and the interest coupon is distributed as described above. In an "at premium" transaction, the Originator receives a higher consideration up front (usually including the discounted value of the interest strip). While the accounting guidance prescribes that any gain or loss on securitisation must be recorded in the profit and loss account immediately at the time of securitisation (i.e., record the net present value the excess interest spread to be received for the remaining period of the loans securitised), the RBI guidelines require that such gain must be amortised over the tenure of the PTCs issued by the SPV. Under the RBI guidelines, income in the form of excess interest spread received over the life of the loan must be recognised only when only upon actual receipt or flow-back from the SPV. For "at premium" transactions, the guidelines have prescribed a formula for amortisation of the premium received whereby the amount to be recognised shall be the higher of (a) amount proportionate to principal amortised; or (b) amount amortised on a straight line basis (i.e. time proportionate); or (c) equivalent of any losses recognised by the Originator. In view of the overriding effect of the RBI guidelines, all financial enterprises have hitherto been amortising such gain on securitisation i.e., they record the excess interest spread as and when received.

  With regards to losses on securitisation however, there is no conflict or contradiction between the guidance note and the RBI as both require an upfront recognition of such loss.

- **Credit enhancement:** A usual feature of securitisation is 'credit enhancement', i.e., an arrangement which is designed to protect the investors in the securitisation trust from credit losses and/or cash flow mismatches arising from shortfall or delays in collections. Credit enhancement is a form of guarantee usually provided by the Originator whereby he undertakes to absorb a certain portion of the initial losses arising on the securitised assets on account of any shortfalls in collections. The Originator usually provides a fixed deposit as a collateral for the credit enhancement provided. At every pay out date to the investors in the securitisation trust, if the funds collected from the underlying loan portfolio are not sufficient to pay the amounts due, the trustees will recover the shortfall up to the extent of the credit enhancement from the collateral provided and make the pay outs to the investors. The RBI guidelines require any amount of such shortfall recovered from the credit enhancement should be immediately charged off to profit and loss account of the Originator.

- **Servicing fee:** In most securitisation transactions, the Originator enters to a separate servicing arrangement with the securitisation trust whereby it is responsible for continuing to service and make collections from the borrowers of the underlying loan transaction. The trust typically pays a servicing fee to the Originator for these services. The service fee income is recorded on an accrual basis by the Originator.

Accounting considerations for the Securitisation trust or SPV

There are no specific accounting guidelines or regulations issued which govern the accounting for trust books. Accordingly these would follow generally accepted accounting principles. The trust would recognise the asset received under a securitisation transaction, if the Originator loses control over the securitised asset. It issues Pass Through Certificates (PTCs) to raise funds from investors to pay the purchase consideration to the Originator. The amount received by the SPV on issue of PTCs or other securities should be shown on the liability side of the balance sheet, with appropriate description, keeping in view the nature of securities issued. It acts as a pass through and accordingly income recorded on loans should be matched with interest expense on PTCs and other expenditures like servicing fee. Any shortfalls in loan collection are received from the credit enhancement provided from the Originator and paid out the PTC holders. Any excess collections e.g., prepayments or foreclosures payments received are distributed to the PTC holders as they are received, and reduce the future interest income collection from the underlying loans and the interest payouts to the PTC holders.

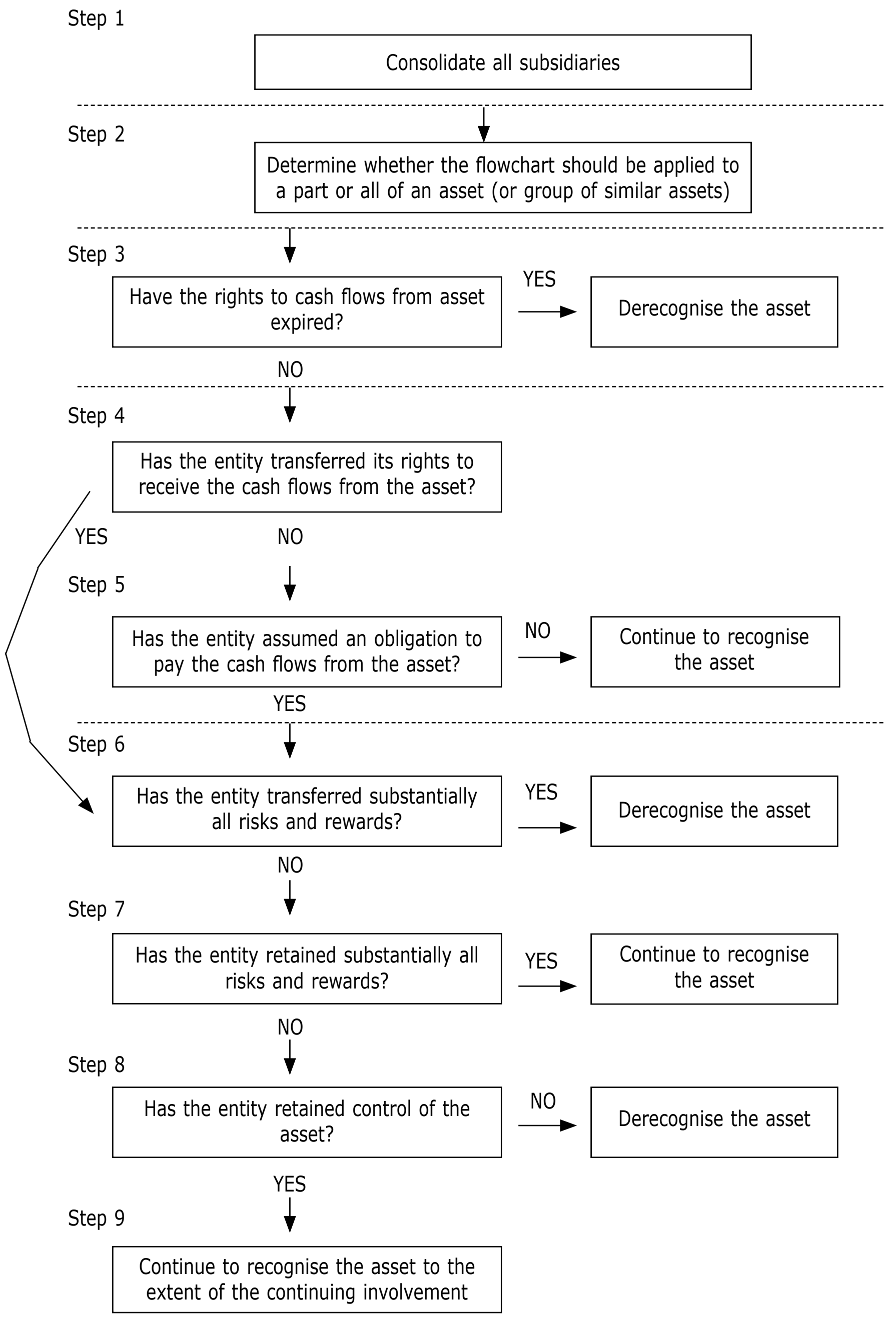
Accounting considerations for the investors

The investor should account for the PTCs and/or debt securities acquired by it as an investment in accordance with Accounting Standard (AS) 13, 'Accounting for Investments' or extant RBI guidelines in case the investor is a NBFC or Bank. As per the RBI guidelines, the investment in PTC is recorded at the lower of cost or market value. Prior to June 2016, the PTC were valued as tax free bonds. However, as the Finance Bill 2016 changed the tax treatment for these instruments, the valuation methodology as advised by Fixed Income, Money Market and Derivative Association (FIMMDA) has undergone a change. Currently, the PTCs that are issued in respect of securitisation of loans that qualify as priority sector loans (PSL) are valued at their book value.

ACCOUNTING UNDER IND-AS

Accounting considerations for the Originator

Ind AS 109 provides following step model to determine whether or not to derecognise any financial asset including any assets that are securitised in books of originator:



Consolidation of SPV: The first step under Ind-AS is determine whether the SPV or securitisation will be consolidated with the Originator and, in order to determine whether the Originator needs to consolidate the securitisation SPVs, one needs to determine whether "control" as envisaged in Ind-AS 110 exists.

Ind-AS 110 states, "An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee". This requires all three of the following:

1. Power over the investee, which is described as having existing rights that give the current ability to direct the relevant activities, i.e., the activities that most significantly affect the investee's returns
2. Exposure, or rights, to variable returns from the investor's involvement with the investee
3. The ability to use its power over the investee to affect the amount of the investor's returns

With respect to the above criteria, some of the key points relating to a securitization trust that will ultimately determine which party controls the trust are:

1. The SPV is a separate legal entity sponsored by independent trustee companies. Are these trustee companies related to the Originator or does the Originator exercise any influence over them?
2. Is the Originator also an investor in the trust and if yes, how much is its exposure to variable returns from the trust?
3. Does the credit enhancements provided by the Originator to the SPV result in ensuring the other investors in the trust will received a fixed yield or coupon as agreed? What is the likelihood of the losses exceeding the credit enhancement, and hence impacting yields earned by the investors?
4. What is the extent of the power that the Originator continues to exert over the underlying loans either as a servicing agent or otherwise which could impact the returns generated for the investors?

If the evaluation of the above factors, results in consolidation of the securitisation trust with the Originator, then the originator would consolidate the trust in its consolidated financial statements and will also most likely not achieve true sale for the loans transferred in its standalone financial statements.

Even if the evaluation of the above factors, results in a conclusion that the trust need not be consolidated with Originator, analysis of the remaining steps set out in the flow chart provided in Ind AS 109 will have to be carried out to determine whether the Originator can derecognise (i.e. record a sale) for the loans transferred to the securitisation trust.

The next step to determine whether the Originator has achieved derecognition is to consider whether by transferring the asset to a securitisation trust it has substantially transferred all risks and rewards or it has substantially retained all risks and rewards. It is critical to note that a <u>substantial</u> transfer of <u>all</u> risks and rewards related to the ownership of the transferred asset (i.e., underlying loan portfolio) is required. This evaluation should be done by performing a comparison of the variability of the Originator's cash flows from the underlying assets that has been transferred. The factors that will drive the extent of variability retained by the Originator are the extent of credit enhancement provided, the amount of PTCs it holds in the securitisation trust, the seniority of the PTCs held, and the significance of prepayment risk on the cash flows from the underlying loan pools.

If the originator retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognised in its entirety. If the originator retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the originator could be required to pay.

In case the above evaluation results in a case whether the transferor has neither transferred or retained substantially all the risk and rewards relating to the loan portfolio, Ind AS 109 requires the transferor to determine whether or not it has retained control of the assets. Whether the transferor has retained control of the transferred asset depends on the transferee's (SPV) ability to sell the asset. If the transferee:

- has the practical ability to sell the asset in its entirety to an unrelated third party; and
- is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the originator has not retained control. In all other cases, the originator has retained control.

It is important to note that the decision flow chart as set out in Ind AS 109 has to follow in the hierarchy as set out i.e., the evaluation of whether the transferor has substantially retained all risks and rewards has to be concluded before considering the "control" test set out above.

When an originator transfers a financial asset in a transfer that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, the originator is required to recognise either a servicing asset or a servicing liability for that servicing contract, as follows:

- If the fee to be received is not expected to compensate the entity adequately for performing the servicing, the entity should recognise a servicing liability for the servicing obligation at its fair value.
- If the fee to be received is expected to be more than adequate compensation for the servicing, the entity should recognise a servicing asset for the servicing right.

The recognition of the servicing asset or liability will result in upfront recognition of an income or loss to the profit and loss account.

Accounting considerations for the Securitisation Trust or SPV

There is no requirement currently for securitisation trust to prepare their standalone financial statements as per Ind AS. Accordingly, there is no change expected in the accounting in the books of the securitisation trust.

Accounting considerations for the Investors

The Investor should account for the PTCs and/or debt securities acquired by it as an investment in accordance with Ind AS 109, 'Financial Instruments'. Accordingly, these investments will be accounted for at amortised cost or at fair value through other comprehensive income depending upon the business model of the investor for investing in these securities. The investor may also elect them to account for at fair value through profit and loss. In case it is accounted for at fair value, the fair value will have to be determined in accordance with Ind AS 113 and all changes whether increase or decrease recorded in profit and loss account or the other comprehensive income depending upon the election made by the investor.

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CA Avan Badshaw & CA Mamta Shroff

Securitisation Trusts Direct Tax – Key Provisions

1. Background

Currently, the regulatory framework for the functioning of the securitisation market is primarily governed by *inter alia*, the following:

- The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act);
- The Securitisation Companies and Reconstruction Companies (Reserve Bank) Guidelines and Directions, 2003 as amended from time to time;
- Guidelines on Securitisation of Standard Assets issued by the Reserve Bank of India (RBI); and
- Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008.

In India, securitisation vehicles have pre-dominantly been set-up as trusts with the underlying assets being transferred by way of a sale to the trust.

In a typical loan securitisation transaction, for non-performing loans, the lender transfers the underlying loan portfolio to an Asset Reconstruction Company (ARC) or a trust set-up by the ARC known as the "securitisation trust" and registered under the Indian Trusts Act, 1882. The trust thereafter typically issues security receipts (SRs) to various investors, being qualified buyers as defined under the SARFAESI Act.

Other securitisation vehicles falling outside of the purview of the SARFAESI have also been set-up as trusts. These vehicles do not necessarily hold bad loans but are set-up as a mechanism for balance-sheet management of banks/Non-banking financial companies/other companies to secure investor funding in revenue generating assets. Historically, investors in these trusts have principally been financial institutions like banks and Mutual Funds (MFs). Investment in these non-SARFAESI trusts is typically in the form of "Pass-Through Certificates" (PTCs) which evidence a proportionate ownership of the holder in the requisite underlying assets held by the trust. Thus, the investors holding PTCs are entitled to a beneficial interest in the underlying assets held by the trust which is determined and specified in the trust deed.

2. Taxation framework for securitisation trusts

2.1 Tax framework prior to 2013

Prior to 2013, the Income-tax Act, 1961 (Act) did not contain any specific provisions for taxation of the participants in a securitisation structure i.e., the trust and the beneficiaries of the trust. The taxation of the trust and the beneficiaries was governed by the provisions of the Act as applicable to the taxation of trusts in general.

2.1.1 Taxation of trusts which are irrevocable

As per the provisions dealing with trust taxation, the trustees of a trust are treated as representative assessees who are subject to the same duties, responsibilities and liabilities as the beneficiaries, and the tax treatment of such person is the same as if the income received by the beneficiaries were the income received by or accruing to the representative assessee beneficially.

The trustee(s) may accordingly be taxed on the income received by it (them) on behalf of the investors, and such tax is levied on the trustee(s) in a like manner and to the same extent as it would be levied on the investors(beneficiaries of the trust).

However, if the trust is viewed as carrying on business, the whole of income of the trust liable to tax at the maximum marginal rate (i.e. 30% plus applicable surcharge and health and education cess).

Investors receiving income from the trust are ordinarily liable to tax on the income earned in proportion to the respective investors' investment. Where the trustee is characterised as a representative assessee and accordingly taxed as such, the tax paid by the trustee is deemed to be paid by the investors. In this case ordinarily the investors should again not be required to pay tax individually on the same income.

It is pertinent to note that the Act empowers the tax authorities to either assess the representative assessee (i.e. the trustee) or the beneficiaries of the trust and does not bar them from assessing the other also. However, tax on the same income should not be recovered twice.

Alternatively, where the beneficiaries of a trust are unknown or indeterminate, income of such a trust is then taxable in the hands of the trustee at the maximum marginal rate (i.e. 30% plus applicable surcharge and education cess).

2.1.2 Taxation of trusts which are revocable[1]

Where the trust is treated as a revocable trust, the income arising to the trust is subject to tax in the hands of the person assigning the loan to the trust.

Typically, the securitisation trusts were set-up as revocable trusts to enable the beneficiaries to offer the income to tax directly taking their specific tax positions into consideration given that principally the subscribers to the PTCs were banks and MFs (these entities are exempt from withholding tax on interest under domestic tax laws).

From an income-tax perspective, the income earned by the investors from the trust was offered to tax directly by them and the trust used to obtain an undertaking from these investors as an evidence for discharge of taxes/ compliance with the income-tax laws.

The trusts issued distribution statements, often bifurcating the amount distributed to the investors into principal and interest net of expenses (without providing a classification of the income earned by the trust into a head of income under the Act i.e., business income, capital gains, etc).

Basis the distribution statement, banks typically offered the income earned from PTCs / SRs as their ordinary/ business income, taxable at 30% on a net income basis. Mutual funds being exempt from tax under the provisions of the Act, the income earned by them from PTCs was treated as exempt from tax in their hands.

2.1.3 Litigation resulting from the above provisions

In the absence of specific provisions governing securitisation trusts, the positions in relation to taxation taken by certain securitisation trusts, was questioned by the Revenue authorities. Issues raised included (a) whether trusts are the real

1 A transfer of assets to a trust is treated as revocable if it contains any provisions for the re-transfer of any part of the income or assets to the transferor or gives the transferor a right to resume power over any part of the income or assets.

'owners' of the receivables or are they 'conduits' for the real owners which are the MFs/ NBFCs; and (b) whether the income that these trusts receive is taxable in the hands of the trust under the head 'Profits and Gains of Business or Profession' and taxable in the hands of the trust at the maximum marginal rate.

Consequential demands were raised and recovery initiated from certain (tax exempt) mutual fund investors resulting in protracted litigation. While the matter was ultimately resolved through the judicial process, the litigation caused concerns in the investor community with regard to the securitisation structure resulting in a slowdown in the securitisation industry.

2.2 Amendments made by the Act by the Finance Act, 2013

Acknowledging various representations of the industry in this regard, in order to facilitate the securitisation process and address the above controversy, the Finance Act 2013 introduced a special taxation regime [section 10(23DA), section 10(35A) and Chapter XII-EA of the Act] in respect of taxation of income of securitisation entities, set up as a trust, from the activity of securitisation.

The salient features of the regime were as follows:

- In case of securitisation vehicles which are set up as a trust and the activities of which are regulated by either, Securities and Exchange Board of India (SEBI) or the Reserve Bank of India (RBI), the income from the activity of securitisation of such trusts was exempt from taxation.
- Securitisation trust was liable to pay income-tax on income distributed to its investors on the line of distribution tax levied in the case of mutual funds.
- The income-tax was levied @ 25% in case of distribution being made to investors who are individuals and Hindu Undivided Family (HUF) and @ 30% in other cases.
- No income-tax was payable if the income distributed by the ST is received by a person who is exempt from tax under the domestic tax law (i.e. MFs).
- Consequent to the levy of distribution tax, the distributed income received by the investor was exempt from tax.

The above provisions still did not provide the much needed impetus to the securitisation market which had come to a standstill subsequent to the approach adopted by the tax authorities. The concerns arising from these new provisions were:

- The distribution received by the investors of securitisation trust suffered taxation on a gross basis at a significantly high rate of 30% (for taxpayers other than an individual and a Hindu Undivided family);
- As the income received by the investors was exempt from tax, as per the provisions of the Act, a disallowance of expenses incurred in relation to the said income would have to be made by the investors in their tax returns.
- Trusts set up under SARFAESI Act were not covered.

2.3 Amendments made by the Finance Act, 2016 (applicable with effect from 1 June 2016)

To address the concerns arising from the tax regime for securitisation trust introduced by the Finance Act, 2013, the Finance Act, 2016 has replaced the erstwhile special regime for securitisation trust by a new regime. The new regime is captured by section 10(23DA), section 115TCA and section 194LBC of the Act.

The provisions start with a *non-obstante* clause and apply irrespective of the other provisions of the Act. These provisions are applicable to the following type of the securitisation vehicles/ instruments:

(i) "special purpose distinct entity" as governed by the Securities and Exchange Board of

India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008 and regulated under the said regulations[2]; or

(ii) "special Purpose Vehicle" as defined in, and regulated by, the guidelines on securitisation of standard assets issued by the RBI[3]; or

(iii) trust set-up by an asset reconstruction company formed under SARFAESI Act or in pursuance of any guidelines or directions issued for the said purposes by the RBI which fulfils such conditions, as may be prescribed.

Thus, the special regime of tax introduced for securitisation vehicles is applicable for both, standard as well non-standard acquiring vehicles including a trust under SARFAESI Act which was not covered under the amendment by the Finance Act, 2013. However, it is pertinent to note that the ARCs themselves are not covered by these provisions. Hence, where the ARCs acquire the loan assets on their own books[4], the taxation of the ARCs will be governed by the normal provisions of the Act (including dividend distribution tax, minimum alternate tax, etc.).

2.3.1 *Taxation of the securitisation trust*

As per section 10(23DA) of the Act, any income of a securitisation trust from the activity of securitisation is exempt from tax.

The Explanation to section 10(23DA) defines "securitisation" to have the same meaning as assigned to it:

(i) in regulation 2(1)(r) of the Securities and Exchange Board of India (Public Offer and Listing of Securitised Debt Instruments) Regulations, 2008[5]; or

(ii) in section 2(1)(z) of the SARFAESI Act[6];

(iii) under the guidelines on securitisation of standard assets issued by the RBI[7].

Thus, any income earned by any of the securitisation trusts as referred to in section 115TCA from the defined securitisation activities is exempt from tax.

2.3.2 *Taxation of the investors in the securitisation trust*

As per section 115TCA(1) of the Act, any income accruing or arising to, or received by, a person, being an investor of a securitisation trust, out of investments made in the securitisation trust, shall be chargeable to income-tax in the same manner as if it were the income accruing or arising to, or received by, such person, had the investments by the securitisation trust been made directly by him.

Further, as per section 115TCA(2) of the Act, the income paid or credited by the securitisation trust shall be deemed to be of the same nature and in the same proportion in the hands of the

2 "Special Purpose Distinct Entity" has been defined as a trust which acquires debt or receivables out of funds mobilised by it by issuance of securitised debt instruments through one or more schemes, and includes any trust set-up by the National Housing Bank under the National Housing Bank Act, 1987 or by the by the National Bank for Agriculture and Rural Development under the National Bank for Agriculture and Rural Development Act, 1981

"SPV" means any company, trust or other entity constituted or established for a specific purpose – (a) activities of which are limited to those for accomplishing the purpose of the company, trust or other entity as the case may be; and (b) which is structured in a manner intended to isolate the corporation, trust or entity as the case may be, from the credit risk of an originator to make it bankruptcy remote

4 Under SARFAESI Act, an ARC can acquire loan assets either on its own books or by way of setting-up a trust. Typically, a trust is set-up from an administrative convenience perspective

5 means acquisition of debt or receivables by any special purpose distinct entity from any originator or originators for the purpose of issuance of securitised debt instruments to investors based on such debt or receivables and such issuance

6 means acquisition of financial assets by any securitisation company or reconstruction company from any originator, whether by raising of funds by such securitisation company or reconstruction company from qualified institutional buyers by issue of security receipts representing undivided interest in such financial assets or otherwise

7 means a process by which a single performing asset or a pool of performing assets are sold to a bankruptcy remote SPV and transferred from the balance sheet of the originator to the SPV in return for an immediate cash payment

person referred to in sub-section (1), as if it had been received by, or had accrued or arisen to, the securitisation trust during the previous year.

Thus, based on the reading of section 115TCA(1) with section 115TCA(2), in order to determine the taxability in the hands of the investors in the securitisation trust, one will need to take into consideration the characterisation of the amount earned by the securitisation trust.

As per section 115TCA(3) of the Act, the income accruing or arising to, or received by, the securitisation trust, during a previous year, if not paid or credited to its investors, shall be deemed to have been credited to the account of the said person on the last day of the previous year in the same proportion in which such person would have been entitled to receive the income had it been paid in the previous year.

Given the above, an investor in a securitisation trust will be taxable in its hands in relation to the income earned by the securitisation trust in the like and same manner as that of the trust. Where the securitisation trust does not distribute any amount as at the year end, the same is deemed to be credited in the hands of the investors and taxed accordingly. Such income is not again taxable in the hands of the investors in the subsequent years when it is distributed [section 115TCA(5) of the Act].

2.3.3 Reporting by the securitisation trust

As per section 115TCA(4) of the Act, the securitisation trust is required to furnish within the prescribed time as may be prescribed to the person who is liable to tax in respect of such income and to the prescribed income-tax authority, a statement in such form and verified in such manner, giving details of the nature of the income paid or credited during the previous year and such other relevant details, as may be prescribed.

Rule 12CC was inserted in the Income-tax Rules, 1962 (Rules) by way of an amendment [Income-tax (Thirty Third Amendment) Rules, 2016 with retrospective effect from 1st June 2016.

As per Rule 12CC(1) read with Rule 12CC(2) of the Rules, the statement of income, in Form 64E, distributed by a securitisation trust to its investor shall be furnished to the Principal Commissioner or the Commissioner of Income-tax within whose jurisdiction the principal office of the securitisation trust is situated, by 30th November of the financial year following the previous year during which such income is distributed. Further, the statement of income, in Form 64F, distributed is required to be furnished to the investor by 30th June of the financial year following the previous year during which the income is distributed.

Both under Form 64E and Form 64F, the securitisation trust is required to provide the details of amount under various heads of income.

Thus, based on the reading of section 115TCA(1) and section 115TCA(2) of the Act and the reporting in Form 64E and Form 64F, the securitisation trust is required to determine the characterisation of income first and report it to the investors and the investors based on such characterisation are required to offer the income to tax.

This may create certain challenges for certain investors such as foreign portfolio investors who are typically only permitted to invest in securities (and not underlying loan portfolios) but may end up paying higher or lower income-tax (as the provisions of section 115AD of the Act applies to income from securities and based on the specific provisions of the applicable Double Taxation Avoidance Agreement) if the characterisation as determined by the securitisation trust has to flow through.

2.3.4 Applicability of Tax Deduction (TDS) provisions for payments made to securitisation trust

The Central Board of Direct Taxes, on 17th June 2016, issued a notification[8] providing that no deduction of tax shall be made on any payments

8 Notification no. 46/ 2016

to the trust for the securitisation activity. This effectively has taken care of the area of past litigation on the requirement of TDS or withholding tax on payments made to the securitisation trust.

2.3.5 *Applicability of TDS provisions from payments/ credits by securitisation trust to its investors*

As per section 194LBC of the Act, securitisation trust is required to withhold tax at the following rates:

- 25% in case of payments to individuals and Hindu Undivided Family (HUF);
- 30% in case of others
- Rates in force[9] in case of payments to non-resident investors.

Investors can also obtain a certificate for lower/ NIL rate of withholding tax.

Tax withholding at higher rates

Section 206AA of the Act provides that where a recipient of income (which is subject to withholding tax) does not have a Permanent Account Number (PAN), then tax is required to be deducted by the payer at higher of the following:

- rates specified in relevant provisions of the Act; or
- rates in force; or
- at the rate of 20%.

The above shall not apply to non-residents in respect of payments in the nature of interest, royalty, fees for technical services and payment on transfer of capital assets provided the non-residents provide the following information to the payer of such income:

- Name, e-mail-ID, contact number;
- Address in the country of residence;
- Tax Residency Certificate (TRC), if the law of country of residence provides for such certificate;
- Tax Identification Number (TIN) in the country residence.
- Where TIN is not available, a unique identification number is required to be furnished through which the non-resident investors are identified in the country of residence.

Snapshot

The provisions introduced by the Finance Act, 2016 as discussed above have been summarised below in a table for ready reference.

Particulars	**Provisions as introduced by the Finance Act, 2016**
Date of applicability	Effective from 1 June 2016
Nature of securitisation trust covered	– SEBI regulated funds for securitisation of debt or receivable; or – as defined in the guidelines on securitisation of standard assets issued RBI; or – an ARC in accordance with the SARFAESI Act or in pursuance of any guidelines or directions issued for the said purpose by the RBI
Availability of pass through status to the securitisation trust	Yes
Whether distributed income is deemed to be credited to investors at the end of the year	Yes
Whether investors enjoy exemption on distributed income	No, taxable at their own applicable rates

9 Rate or rates of income-tax specified in the Finance Act of the relevant year or the rate or rates of income-tax specified in an applicable Double Taxation Avoidance Agreement entered into by the Government of India.

Particulars	Provisions as introduced by the Finance Act, 2016
Distribution tax payable by securitisation trust	Not applicable
Withholding tax obligation on securitisation trust while making payment to the investor	– 25% in case of payment made to individuals or HUF; – 30% in case of others; – Rates in force (rate under the relevant Double Taxation Avoidance Agreement or under domestic law, whichever is beneficial) in case of payments to non-resident investor
Whether investor can apply for Nil/ lower withholding certificate	Yes

2.3.6 *Filing of income-tax return by the securitisation trust*

The securitisation trust is required to file the income-tax return as per section 139(4C) of the Act.

2.3.7 *Taxability of income of the securitisation trust in the hands of the investors*

Depending on the underlying loan assets and the nature of securitisation (good assets or NPAs), the securitisation trust could earn income in the nature of interest income or upside other than the principal repayments or may write off the loans. The securitisation trust would need to categorise / classify the same as business income or investment income/ income from other sources for the purpose of investor reporting in Form 64E and Form 64F.

In the case of a non-resident investors, the taxability is governed by the provisions of the Act or the applicable Double Taxation Avoidance Agreement (DTAA), if any, whichever is more beneficial. The tax implications applicable to non-resident investors in a securitisation trust under a beneficial DTAA, would need to be analysed based on the specific facts.

Further, depending on the characterisation of income as reflected by the securitisation trust, the tax residency of the investor and applicability of DTAA provisions, the investors would need to determine if any claim for expenses can be made against the interest income/ upside.

The investors would also need to analyse the applicability of Income Computation and Disclosure Standards where the income reported by the securitisation trust is in the nature of "business income" or "income from other sources".

2.3.8 *Filing of income-tax returns by the investors*

The investors in the securitisation trust would need to file income-tax returns reflecting the share of income earned from the securitisation trust and offered by them to tax under the provisions of the Act.

3. Concluding remarks

The present regime laying down the framework for the taxation of securitisation trusts is still in a relatively nascent stage. Further, the market in relation to broad based foreign investment into securitisation trusts, especially in relation to NPAs is presently developing, and it is likely that we will see a greater market movement in this context in the near and short term.

Accordingly, it is likely that certain practical issues in implementing the same from the income-tax perspective will emerge in the coming months and would need to be addressed.

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CA Smita Bhandari & CA Dhrumil Vasaiwala

Securitisation Trusts Indirect Tax – Key Provisions

The introduction of the Goods and Services Tax (GST) in India was much awaited carrying the promise of a single tax with zero cascading, resulting in ease of compliance as compared with the erstwhile indirect tax laws. The expectation was of a much easier and clearer regime and needless to add that like any other change of such large magnitude, there were certain hits and misses.

Specifically, in the context of taxing financial services, it has always had a wide coverage in terms of including large part of the sector within the fold of indirect tax (under service tax/ VAT), and the same has continued under the GST. Segments such as fee based banking services, activities under the capital markets such as stock broking, investment banking, mergers and acquisitions, portfolio management, etc., as well as certain trading activities in bullion and foreign exchange fall within the purview of GST. Interest on loans/ deposits continue to be outside the purview of GST.

Secondary market transactions such as trading in securities as well as assignment and securitisation of loans, have been outside the purview of the erstwhile indirect taxation, both service tax and VAT, given that the same did not qualify as "service" or "goods" as defined under the respective laws.

The activities of securitisation trusts accordingly, were not liable to indirect taxes, being in the nature of capital transactions. Similarly on the cost side, primarily services purchased such as of the management company carried an indirect tax cost which was a cost to the trust.

The ensuing paragraphs discuss the impact on typical securitisation transactions and accordingly, on the securitisation trusts under the new GST regime.

Constituents of a securitisation transaction

Securitisation represents a shift in the way businesses borrow funds. Where traditionally loans were borrowed from banks, businesses have increasingly relied upon securities sold on financial markets. The process of securitisation allows the transformation of a non-marketed assets into marketable assets, securities.

In India, securitisation vehicles have historically been pre-dominantly set-up adopting a trust structure with the underlying assets being transferred by way of sale to a securitisation trust (hereinafter referred to as a 'Special Purpose Vehicle' or 'SPV'). The original lender, being a financial institution engaged in lending money, transfers its receivables portfolio to this trust/ SPV. The SPV purchases the portfolio by issuing pass through certificates ('PTC') or Security Receipt to various investors being qualified buyers, in return for investment. Through issuance of PTCs the income arising from the receivables is passed onto the investors. Sometimes, securitisation involves assignment of the receivable wherein the loan asset is directly sold to the investors.

The securitisation transaction therefore has the following typical transactions:

I. Assignment of the loans/receivables to the SPV

II. Issue of PTCs to the investors and servicing of the PTCs

Impact of GST on securitisation transactions

Taxability under GST is a culmination of the three factors: 'supply', 'goods or service' and 'consideration'.

Under the GST regime, any 'supply'[1] as defined under the Goods and Service Tax Act, 2017 ('the Act'), triggers a levy of tax unless the same has been exempted under the law or vide any notification. A supply can be either of 'goods' or 'services'. While the ambit of 'goods' has been specifically defined under the Act, 'services' includes everything other than 'goods, money and securities'.

Further, the terms 'money' and 'securities' are excluded from the both 'goods'[2] and 'services'[3], it shall be noted that the definition of goods includes 'actionable claims'. Even schedule III of the CGST Act – Activities or transactions which shall be treated neither as a supply of goods nor services, includes actionable claims.

The definitions mentioned above are critical to understand the impact and ambiguities created under the GST legislation with regard to the securitisation transaction.

Whether transfer/ assignment of loan portfolio to the securitisation trust is a 'transaction in money'?

- As discussed above, the GST regime intends to tax all activities for a consideration (being goods or services) unless specifically excluded / exempted. 'Money'[4] is outside the purview of GST. While 'money' is defined under the Act, 'transactions in money' has neither been defined nor clarified for the purpose of the GST law, unlike the service tax legislation which specifically excluded transaction in money and its scope was clarified by way of a clarification from the Department of Revenue.

  Therefore, the primary challenge under the GST law is that the law is not explicit in either defining transactions in money

1. As per Section 7 of the Act, 'supply' includes all forms of supply of goods or services such as exchange, sale, transfer etc made for a consideration by a person in the course of furtherance of business.
2. As per Section 2(52) of the Act,' Goods' mean - every kind of movable property other than money and securities but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply
3. As per Section 2(102) of the Act, "services" means anything other than goods, money and securities but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged;
4. As per Section 2(75), 'money' means 'Indian legal tender or any foreign currency, cheque, promissory note, bill of exchange, letter of credit, draft, pay order, traveller cheque, money order, postal or electronic remittance or any other instrument recognised by the Reserve Bank of India when used as a consideration to settle an obligation or exchange with Indian legal tender of another denomination but shall not include any currency that is held for its numismatic value'.

or even clarifying its scope, leading to the ambiguities in interpretation.

- While money itself is excluded from the definition of 'money', Section 2(102) of the CGST Act includes, any activity relating to use of money or its conversion (mode, currency, form, denomination) for which a fee is charged. For example, the purchase of USD in exchange of INR itself is "money", however, if a fee is charged for the same conversion, it would be a taxable transactions where the fee would be a "service" liable to tax.

  It is important to understand that the value of any goods/ services is a cumulative sum of the value added in the process of its creation. Money (or even financial security), by contrast, is simply an instrument evidencing some sort of promise or agreement to pay an amount to the holder in the event of certain conditions being met. It is a means of transferring purchasing power from one person to the other, and not a product to be consumed.

- One could argue that the securitisation being in the nature of extending a loan or a bill discounted (like discounting / liquidating future cash flows arising out of a loan asset), is nothing but a "loan" and therefore, being capital transaction in 'money' should not be liable to tax.

  The analogy is that securitisation is a refinance of receivables such that the original lender receives the sum originally lent (to the extent of loan financed) and the loan is transferred to a third party financer. Thus, in essence the original lender becomes the borrower. Thus, the transaction of securitisation of debt by way of transfer of the loan portfolio appears to be in the nature of a 'transaction in money'.

  Similar principles exist in the international GST legislations. In the case of MBNA Europe Bank, the Chancery Court discussed whether a credit card securitization amounts to a taxable supply for VAT purposes. After elaborate discussion on the nature of securitization, and referring to findings of lower authorities that securitization is nothing but a sophisticated form of borrowing, the Chancery Court held that the assignment of receivables in a securitization was not a supply at all.

  In this regard one could also draw reference from the clarification issued under the Education Guide published by the Central Board of Excise and Customs on 20th June 2012 under the service tax law, where it was clarified that the acquisition of secured debt is nothing but transaction in money. This can have a persuasive value in interpreting the provisions of GST given that the broad principles governing the tax on services have not undergone change.

- Having said the above, traditionally, what constitutes a "loan" itself has been a matter of debate where on several similar transactions such as collateralised lending and borrowing obligation is under litigation. Therefore, the risk of whether a securitisation is a "loan" or classified under the wider term of "transaction in money" is open for interpretation.

  The above ambiguity is evidenced by the recent FAQ issued by the Central Board of Indirect Taxes on the financial services sector where a securitisation ie transfer of loan/ assignment of a secured debt has been referred to as a transaction in securities and therefore not taxable.

  While the above is contrary to the Board clarification under service tax of securitisation being a transaction in money, the FAQ achieves the same outcome as the Education Guide on the taxability of a securitisation transaction viz. it is not liable to tax. However, this particular FAQ clarification broaches with it a new question on how does the classification of the securitisation transaction into a transaction in security, impact the input tax credits for the financial institution off-loading the loan portfolio.

Whether transfer of loan portfolio is an actionable claim?

- Another credible argument to evaluate on taxability of securitisation transactions is whether such transactions qualify as 'actionable claims'. An 'actionable claim' other than lottery or gambling is neither treated as supply of goods. The question therefore is what qualifies as an 'actionable claim' under the GST laws.

- As per section 3 of the Transfer of Property Act, 1893 actionable claims means a claim to any debt, other than a debt secured by mortgage of immovable property or by hypothecation or pledge of movable property or to any beneficial interest in movable property not in the possession, either actual or constructive, of the claimant, which the Civil Courts recognize as affording grounds for relief, whether such debt or beneficial interest be existent, accruing, conditional or contingent. An obvious example of an actionable claim would be the right to participate in the draw to be held in a lottery.

- In this regard, it would be imperative to make reference to the Education Guide released in 2012, wherein it had been clarified that an unsecured debt transferred to a third person for consideration shall be outside the purview of service since an unsecured debt is an actionable claim.

- The important aspect of the above definition of 'actionable claim' as well as the clarification in the Education Guide is the fact that neither includes a secured debt; This raises a question as to whether secured receivables are excluded from the purview of GST because the loan portfolio assigned to a securitisation trust could be secured as well as unsecured.

- Conceptually, if one looks at the levy of GST – it is a consumption based tax which is leviable on supply of goods or services. An 'actionable claim' being a claim on 'money' is sought to be excluded from levy of GST since money is neither 'goods' nor 'services.

  Keeping in line with the aforesaid concept, merely since the debt is secured by a security, does not result in it ceasing to be a claim to money receivable. This is since the assignee of the debt possesses a right with respect to the money receivable. The assignee may liquidate the underlying security only if there is default with respect to payment of instalments against the receivable. Thus, the loan itself is not a claim on the underlying security but a claim on the receivables; hence may still be considered as money.

Issuance of PTCs by securitisation trust to the investors and servicing of the PTCs

- The SPV finances the purchase of the loan assets by issuance of debt instruments to its beneficiaries (being various investors) against coupon interest. In this way, the incomes or receivables from the securitised assets are sold to investors by issuance of PTC.

- The definition of 'goods' and 'services' excludes securities. 'Securities'[5] shall have the same meaning as assigned to it in SCRA and SARFAESI defines 'security receipts'[6]. Both include the transaction of issuance of an instrument to an investor.
- As discussed, a PTC is an evidence of purchase of undivided right in the debt involved in securitisation. Both PTCs and security receipts are squarely covered in the definition of the term 'securities' under the SCRA since they refer to a certificate/instrument issued to an investor by a special purpose distinct entity (i.e. the securitisation trust), which possesses the receivable. Further, the PTCs acknowledge the beneficial interest of the investor in the underlying debt/receivable.
- Accordingly, servicing of the PTCs and SRs by way of issuance and its repayment against the coupon should be regarded as a transaction of supply of securities and accordingly, not be liable to GST.

Conclusion

To summarise, while the transactions of the securitisation trust of issuing PTC is not liable to GST, the impact of the entire transaction of securitisation (taxation or reversal of credits) would ultimately sit on the Trust. As the GST law matures, the uncertainities in the classification and treatment of financial transactions would be clearer. For the securitisation transaction, the ask would clearly be to grandfather the taxation status under service tax, including the zero impact on input tax credits, into the GST.

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5. As per Section 2(h) of the Securities Contracts (Regulation) Act, 1956 ('SCRA"). 'securities' includes:
6. Security receipt as defined in clause (zg) of section 2 of the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI Act)

   Any certificate or instrument (by whatever name called), issued to an investor by any issuer being a special purpose distinct entity which possesses any debt or receivable, including mortgage debt, assigned to such entity, and acknowledging beneficial interest of such investor in such debt or receivable, including mortgage debt, as the case may be.

   Derivatives

   As per Section 2(1) of SARFAESI Act, "security receipt" is defined to mean a receipt or other security, issued by an asset reconstruction company to any qualified buyer pursuant to a scheme, evidencing the purchase or acquisition by the holder thereof, of an undivided right, title or interest in the financial asset involved in securitisation.

Our first duty is not to hate ourselves, because to advance we must have faith in ourselves first and then in God. He who has no faith in himself can never have faith in God.

— *Swami Vivekananda*

CA Bhairav Dalal & CA Dhiren Thakkar

Real Estate Investment Trusts – An Overview

Introduction

India's real estate sector, backed by robust economic progress has witnessed a swift growth. The expanding scale of operations of the corporate sector in India has increased the demand for commercial buildings and space including offices, retail assets/ malls, conference centres, etc. For such a rapidly growing industry, it was considered crucial that alternate investment vehicles evolve in the country.

Globally, Real Estate Investment Trusts ("REIT") have been in existence since decades. The Dutch regime was the first REIT look alike regime in Europe. Further, the Unite States boasts of the oldest formal REIT regime, having been enacted in 1960 and effective from 1961.

Over the last decade, REITs have developed into a mature market world over, providing easy access to high-quality assets and enabling a stable return on investments.

The number of countries offering REITs as an investment vehicle has increased manifold. Countries such as Australia, Belgium, Canada, France and Germany are said to have 'established REIT markets' while United States is said to have a 'mature' REITs market.

Concept in brief

REITs are entities which own, operate and manage income producing real estate assets. REITs are modelled after mutual funds and offer investors an opportunity to own valuable real estate assets. Real estate sector which is otherwise known for its rigidity is rendered flexibility and liquidity by REITs which increases the entry and exit opportunities for real estate developers, asset owners and financial investors.

REITs worldwide, are also popular investment options for institutions having access to long term pools of capital such as pension funds, mutual funds, insurance companies, etc.

Indian REIT story

In India, Securities and Exchange Board of India (SEBI) enacted Real Estate Investment Trusts Regulations, 2014 (REIT Regulations) on 26th September 2014. Over the years, the regulator has done a commendable job of structuring these regulations by closely partnering with important stakeholders, government bodies, investors and real estate developers in the country, and bringing them in sync with globally recognised norms.

The modelling of the Indian REIT regime on existing successful regimes seems to be a deliberate attempt to ensure consistency as well as to generate stakeholder confidence in these investment vehicles.

SEBI

With a view of making the Indian REIT story a success and propelling the growth of the real estate sector in India, the REIT regulations have undergone number of amendments. When the REIT Regulations were introduced, REITs were allowed to hold real estate assets either directly or through special purpose vehicles (SPV) being companies or limited liability partnerships (LLPs) in which a REIT holds or proposes to hold an equity stake or interest of at least 50%. Recognising that in the existing Indian real estate sector set-up, real estate assets were generally held through two-tiered structures, the REIT Regulations introduced the concept of 'Hold Co'. REIT Regulations define Hold Co as a company or an LLP in which a REIT holds or proposes to hold at least 50% of the equity share capital/ interest and which is not engaged in any activity other than holding of underlying SPVs/ real estate assets. Thus, REITs have been enabled hold real estate assets through two-tiered structures as well.

A detailed analysis of the REIT Regulations is as below.

A	Key aspects	
1	Eligibility	***Sponsor (person who sets up a REIT)*** • No maximum limit on the number of sponsors has been prescribed • Concept of 'sponsor group' has been included in the REIT Regulations • Consolidated net worth of sponsors to be at least INR 100 crore, with each sponsor's net worth being at least INR 20 crore • Sponsor or its associates to have minimum experience of five years in the development of real estate or real estate fund management • Developer sponsors to have a track record of at least two completed projects
		Manager (company, LLP or body corporate) • Minimum net worth of INR 10 crore • Manager or its associates to have minimum experience of five years in fund management, advisory or property management in the real estate sector or real estate development • Manager to have a minimum of two key personnel with minimum five years of experience in fund management, advisory or property management in the real estate sector or real estate development
		Trustee • For being eligible to be appointed as a trustee of a REIT, a person should be (i) registered with SEBI; and (ii) not an associate of the sponsor(s) or manager

2	**Key investment conditions**	***Asset-related conditions*** • At least 80% of the value of REIT assets needs to be invested in completed and rent/ income-generating real estate, with a lock-in period of three years from the date of purchase of the REIT asset or acquisition of share/ interest in Hold Co/ SPV • The balance 20% of the total value of REITs can be: o Under construction properties with a lock-in period of three years after completion o Completed but non-rent generating properties with a lock-in period of three years from the date of purchase o Unlisted equity shares of companies deriving at least 75% of their operating income from real estate activities (subject to lock-in as mentioned above being satisfied where investment in under construction property or completed but non-rent generating property is made through unlisted equity shares) o Listed or unlisted debt of real estate companies (other than investment in debt of Hold Co/ SPV) o Mortgage-backed securities o Equity shares of listed companies in India, generating at least 75% of their operating income from real estate activities o Government securities o Unutilised floor space index (FSI) and transferable development rights (TDR) with respect to existing investments o Cash or money market instruments ***Additional conditions*** • Investment through a Hold Co should be subject to the following requirements: o Ultimate holding interest of the REIT in SPVs to be at least 26% o Other shareholders/ partners of the Hold Co/ SPV should not restrict the REIT, Hold Co or SPV from complying with the REIT Regulations, and an agreement has been entered into with such shareholders/ partners to that effect. Such an agreement to also provide for a dispute resolution mechanism between REIT and the shareholders/ partners o The manager, in consultation with the trustee, shall appoint at least such number of nominees on the board of a Hold Co and/ or SPV which are in proportion to the holding interest of the REIT/ Hold Co in the Hold Co/ SPV o In every meeting of a Hold Co and/ or SPV, voting rights of the REIT shall be exercised

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- Investment not permitted in vacant land, mortgages or agricultural land. However investment in vacant land is permitted where the land is contiguous and an extension of the existing project being implemented in stages.
- At least 51% of the consolidated revenue of the REIT, Hold Co and SPV to be from rental, leasing and letting out of assets, or incidental revenue
- Investment in other REITs or lending by a REIT (except lending to Hold Co/ SPV) is not permitted
- Unitholder's approval required for disposal of a REIT's/ Hold Co's/ SPV's assets or interest in the SPV is required if it exceeds 10% of the value of the REIT assets in a financial year
- Co-investment is permitted subject to the following conditions:
  - o Investment by the other person shall not be at terms more favourable than those to the REIT
  - o The investment shall not provide any rights to the person which shall prevent the REIT from complying with the provisions of the REIT Regulations
  - o The agreement with such person shall include the minimum percentage of distributable cash flows that will be distributed and entitlement of the REIT to receive not less than pro rata distributions

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<tr><td>3</td><td>Distribution policy</td><td>

- Minimum of 90% of the net distributable cash flow of a REIT should be distributed to unitholders
- Minimum net distributable cash flows to be distributed by a HoldCo to a REIT (subject to provisions of the Companies Act, 2013, and Limited Liability Partnership Act, 2008):
  - o 100% of cash flows received from SPVs; and
  - o 90% of the balance
- An SPV to distribute a minimum of 90% of its net distributable cash flows to a REIT/HoldCo
- A REIT is to distribute at least 90% of the sale proceeds arising from the sale of property or equity shares/interest in a HoldCo/SPV, unless reinvestment is proposed within a period of 1 year
- REITs/ HoldCo/ SPV to undertake distribution at least once every six months

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4	**Public offer**	• Minimum value of REIT assets for a REIT to be floated: INR 500 crore • Slabs for minimum public float: o If post-issue capital is less than INR 1,600 crore: 25% of the post-issue capital or INR 250 crore, whichever is higher o If post-issue capital is equal to or more than INR 1,600 crore but less than INR 4,000 crore: Minimum INR 400 crore o If post-issue capital is equal to or more than INR 4,000 crore: Minimum 10% of the post-issue capital • However, the public float, if lower pursuant to the above mentioned slabs, shall be increased to a minimum of 25% of the post-issue capital within a period of three years from the date of listing. Minimum subscription amount: INR 2 lakh per applicant • Trading lot: INR 1 lakh
5	**Listing requirements**	• Mandatory listing within 12 working days of the IPO • Minimum public subscription: 90% of the fresh issue size • Minimum number of subscribers: 200 at the time of public offer (other than related parties of the REIT). Further, a qualified institutional buyer shall be deemed to be a public subscriber even if it is a related party of the REIT. No mandatory delisting prescribed if the number of public unitholders falls below 200
6	**Leveraging**	• Aggregate consolidated borrowings and deferred payments of the REIT, HoldCo and SPV(s) net of cash and cash equivalents (not including refundable security deposits to tenants) to be capped at 49% of the value of the REIT's assets • Such net consolidated borrowings and deferred payments of the REIT, Hold Co and SPV(s) higher than 25% of the REIT's assets to be subject to the following: o Credit rating (no minimum rating prescribed) o Approval of the unitholders (where the number of votes cast in favour are more than the number of votes cast against)
7	**Related party transactions**	• Permission granted under the REIT Regulations subject to the following: o Arm's-length requirement being met o Specified disclosures being made to unitholders and the stock exchange o Valuation reports or fairness opinions being obtained from independent valuers in the case of specified transactions (for instance, buying and selling of assets)

		o Unit holder's approval would be required for the following: – Acquisition or sale of properties/ investments from or to related parties (whether directly or through the Hold Co/ SPV), the total value of which in a financial year exceeds 10% of the value of the REIT assets; and – Borrowings from related parties in a financial year exceeding 10% of total consolidated borrowings of the REIT, HoldCo and SPV(s)
8	**Funds for general purpose**	• Maximum 10% of the amount raised by a REIT by public issue of units can be used for 'general purposes', as mentioned in the offer document • Issue-related expenses not to be considered as a part of general purposes
9	**Key rights and responsibilities**	***Sponsor(s) and sponsor groups*** • Setting up a REIT and appointing a trustee • Transferring or undertaking to transfer assets, interests and rights in the Hold Co/ SPV to the REIT before allotment of units to applicants • Sponsors and sponsor group shall collectively hold: o Minimum of 25% of the total units of a REIT on a post-issue basis for a period of three years from initial offer (one year lock-in period for post-IPO holding in excess of 25%); o Minimum of 15% of the outstanding units of a listed REIT at all times; and o Each sponsor shall hold a minimum of 5% of the outstanding units of a REIT at all times • Divestment of the 15% continued holding mentioned above is possible subject to the following: o Completion of a three-year lock-in period from the listing date o Another sponsor acquiring the minimum holding with the prior approval of the unitholders or the unitholders being given an option to exit - Not to apply where divestment is by way of sale to an existing sponsor
		Manager • Ensuring that a REIT's, HoldCo's and SPV's assets have proper legal, binding and marketable titles and agreements

		• Identifying and recommending investment opportunities • Complying with the conditions and strategy mandated for the investment • Appointing other service providers in consultation with trustee • Undertaking lease and property management (directly or through agents) • Ensuring that a REIT's assets are adequately insured • Addressing unitholder's grievances and distribution-related issues • Ensuring annual audit of a REIT's accounts by an auditor • Overseeing developmental activities • Providing activity and performance reports on a REIT every three months to its board or governing board • Ensuring adequate disclosure and timely submission of documents to the concerned stock exchange • Maintaining records pertaining to activities of a REIT for a minimum period of seven years
		Trustee • Appointing a manager and executing his or her agreement • Overseeing the manager's activities and operations and obtaining compliance certificates on a quarterly basis • Reviewing related party transactions • Obtaining unitholder's approval on specified matters
B	*Other aspects*	
1	**Legal form**	• A REIT is to be mandatorily set up as a trust • No other form of entity (e.g. a company or LLP is permitted)
2	**Key definitions**	Sponsor group • Sponsor group includes: o Sponsor o Where the sponsor is a body corporate: - entities/persons controlled by such body corporate - entities/persons controlling such body corporate - entities/persons controlled by entities/persons controlling such body corporate

		o Where the sponsor is an individual: - immediate relatives of such individual (i.e. spouse of that person, parents, brother, sister or child of the person or of the spouse of the person) - entities/ persons controlled by such individual ***Completed property*** • Property for which occupancy certificate has been granted by the relevant authority ***Real estate or property*** • Land and any permanently attached improvements made to it, whether leasehold or freehold, including buildings, sheds, fittings and any other assets incidental to the ownership of real estate • Hotels, hospitals and convention centres, forming part of composite real estate projects, whether rent generating or income generating • Common infrastructure for composite real estate projects, industrial parks and special economic zones (SEZs) • Excluding mortgages and any asset considered as 'infrastructure', as defined by the Ministry of Finance ***Related party*** • The definition of 'related party' for REIT Regulations has been aligned with the definition provided in the Companies Act, 2013, and under applicable accounting standards and also includes: o Sponsor group(s), re-designated sponsor(s), manager and trustee; and o Promoters, directors and partners of the sponsor group(s), re-designated sponsor(s), manager and trustee ***Hold Co*** • A company or an LLP in which a REIT holds or proposes to hold at least 50% of the equity share capital/interest • Not engaged in any activity other than holding of underlying SPVs/ real estate assets ***SPV*** • A company or an LLP in which a REIT or Hold Co holds or proposes to hold an equity stake or interest of at least 50% • 80% of the assets to be investment in properties which should be directly held by such an SPV • Not allowed to be engaged in any activity other than holding and developing property and any incidental activity

3	**Valuation**	• Complete valuation of a REIT (in the prescribed format) to be undertaken at least once every financial year • Valuer to have minimum experience of five years • Valuer not to be an associate of the sponsor, manager/trustee • Half-yearly valuation of REIT assets to be conducted for the half year ending 30th September • Complete valuation to be undertaken for purchase or sale of property; unitholder's approval needed where: o The acquisition price is more than 110% of the valuation o The sale price is less than 90% of such valuation • Two-year cooling-off period for the valuer after every four consecutive years of valuation being done of the same property • Valuer's remuneration not to be linked to the value of the asset
4	**Governance aspects**	• Unitholder's meetings to be convened at least once every year within 120 days from the end of the financial year, with the gap between two meetings not exceeding 15 months • Generally, for the purpose of REIT Regulations, a resolution is considered as passed if unitholders casting votes in favour are more than those casting votes against it • Certain specified matters (for instance, a change in the manager or sponsor, or delisting) to require that votes cast in favour are at least 1.5 times the votes cast against for the resolution to be considered as passed • Annual report to be provided to unitholders within three months from the end of the financial year; half-yearly report to be provided within 45 days from 30 September • Price-sensitive information as well as that having a bearing on operations or the performance of a REIT to be disclosed to the stock exchange
5	**Others**	• Multiple classes of REIT units is not permitted • However, subordinate units carrying inferior rights may be issued to sponsor(s) and their associates • Parity to be maintained between unitholders (no preferential voting or other rights among unitholders)

Thus, SEBI has ensured that REIT Regulations provide a robust platform for the launch of a stable REIT market in India.

Foreign Direct Investment (FDI)

Introduction of REITs as an 'investment vehicle'

The Indian Government, in an attempt to open new avenues from which REITs could access funds, allowed foreign investors to participate in REITs. On 6th May 2015, the Union Cabinet approved the inclusion of REITs as an eligible financial instrument under the Indian exchange control regulations.

Investment in REITs was allowed through the FDI route by introduction of the concept of 'investment vehicles' which interalia include REITs. Separately, the list of sectors in which FDI is prohibited include 'real estate business' or 'construction of farm houses'. In order to enable foreign investment into REITs, these have been specifically excluded from the definition of 'real estate business'.

With a view to integrate the extant reporting structures for foreign investments in the country, Reserve Bank of India (RBI) *vide* its circular dated 7th June 2018 introduced the concept of 'Single Master Form' (SMF). Post notification of the format for SMF, foreign investment in an investment vehicle including REITs would need to be reported in the SMF within 30 days from issue of the REIT units.

Downstream FDI

For the purpose of computing indirect foreign investment, downstream investment by an investment vehicle shall be regarded as domestic investment if both the sponsor and manager of the REIT are Indian owned and controlled. A company is considered to be owned by resident Indian citizens if more than 50% of the capital in it is beneficially owned by resident Indian citizens and/ or Indian companies, which are ultimately owned and controlled by resident Indian citizens. Where the sponsor is an individual, for the downstream investment made by REITs to be reckoned as domestic investment, the sponsor should be resident Indian citizen. Where the sponsor or manager is an LLP, it would be considered to be Indian owned and controlled if more than 50% of the investment in the LLP is contributed by resident Indian citizens and/ or entities which are ultimately owned and controlled by resident Indian citizens and such resident Indian citizens have majority of the profit share.

Further, it has been specifically iterated that the extent of foreign investment in the corpus of REITs should not be a deciding factor for determining whether the downstream investment made by REITs is foreign investment or not (for the purpose of applicability of lock-in, pricing guidelines, sectoral caps, performance linked sector specific conditions, etc. which need to be satisfied where FDI is made into Indian entities).

Exit from FDI in REITs

Sale/ redemption/ repatriation of units in REITs should be permissible under the automatic route.

RBI

Introduction of REITs as 'eligible borrowers'

External commercial borrowings (ECBs) are loans availed by Indian borrowers in foreign currency from non-resident lenders. These are used widely to facilitate access to foreign money by Indian corporations and public sector undertakings. RBI has specified a list of 'eligible borrowers' with respect to ECBs. The list includes REITs thus paving a way for the REITs to access foreign currency loans. REITs have been included in 'Track II' of the eligible borrowers list. Thus, REITs can raise funds through ECBs for a minimum average period of ten years. The long tenure is expected to provide stable funds to REITs during which they can establish their operations and maintain the industry spread thus offering the investors a competitive investment avenue.

Other conditions

Further, the list of lenders for REITs has been kept wide and includes international banks, international capital markets, multilateral financial institutions like Asian Development Bank (ADB), International Finance Corporation (IFC), etc. However, REITs are not permitted to borrow from overseas branches/ subsidiaries of Indian Banks.

A probable issue in the extant ECB regulations could be that the end use restrictions on ECB proceeds includes real estate activities (except development of integrated townships and affordable housing projects) and purchase of land. Considering the fact that REITs are focused on real estate, issuance of a clarification in this requirement could go a long way in propelling REITs as a market and the overall real estate sector of the country.

Separately, ECBs are also allowed to be transferred from one eligible borrower to another. Hence, in case of reorganisations which are prevalent in the Indian real estate sector, the ECB could be transferred thus easing the process of mergers/ amalgamations/ demergers etc.

ECB regulations also specify that the spread which can be charged by ECB lenders to REITS shall not exceed 450 basis points per annum over the benchmark of 6 month LIBOR or applicable benchmark for the currency in which the funds are borrowed. Additionally, the rate at which penal interest can be charged has been specified to be not more than 2 per cent over and above the rate of interest at which the funds have been borrowed. These specifications, in addition to limiting fund outflow, could also help REITs maintain their spread thus making REITs attractive investment options.

Separately, SEBI has issued amendment regulations dated 15th December 2017 permitting REITs to issue debt securities. This is however subject to the condition that the debt securities are listed on recognised stock exchanges.

In view of the restrictions on end use, rate and tenure of funds raised from ECBs, the go-ahead provided to REITs for raising funds from debt securities is expected to enable REITs to raise funds at competitive terms.

Domestic institutional investors

Acknowledging the significance of REITs in India, the scope of domestic institutions eligible to invest in REITs is being widened by the Government so as to boost the availability of funds to REITs. This is evident from the circulars enabling banks, pension funds, mutual funds and insurance companies to participate in REITs. This is expected to encourage participation by large domestic players having access to surplus funds in REITs.

The eligibility of large institutional investors to invest in REIT units would no doubt attract domestic developers towards this opportunity, however the fact remains that liquidity of REIT units once listed could be low as a result of the minimum trading lot requirements. Also, units that are not frequently traded on the stock exchange could trade at a substantial discount thus, further affecting the public demand for these units.

Future outlook

The REIT model has been effectively implemented in several countries. Further, in many of these countries, the REIT market has grown exponentially in terms of market capitalisation.

Understanding the domestic real estate sector conditions and moulding the regulatory framework for REITs according to it, has been recognised as a pre-requisite for establishing a thriving market for REIT units. The REIT Regulations have made the intention of SEBI and other regulators to go this extra mile clear. In the near future, we could expect Indian REITs to increase the depth of the Indian property market with higher transparency and high governance standards.

While the market for REITs is still at a nascent stage in India, infrastructure investment trusts (InvITs) being the REIT counterpart in the infrastructure sector, are relatively ahead of the curve. Though the first REIT if yet to be listed, there have been a few InvIT listings.

However, with various enabling factors such as the growth of the economy and increasing financial literacy, along with the government push to the real estate sector, the future of the Indian REIT markets seems bright.

❍❑❍

CA Kalpesh Desai & CA Payal Bajaj

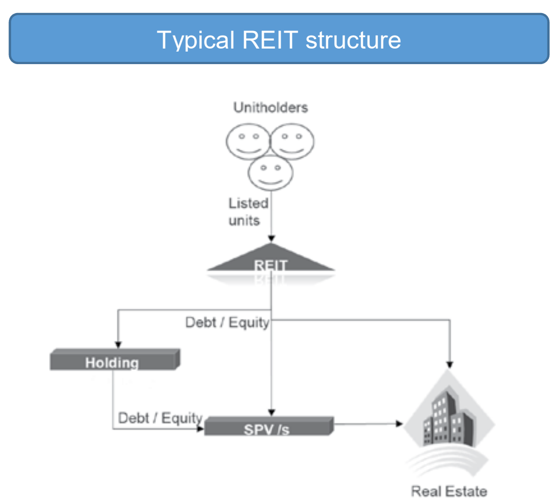
Real Estate Investment Trusts Direct Tax – Key Provisions

The Securities Exchange Board of India ('SEBI') introduced the SEBI (Real Estate Investment Trusts) Regulations, 2014 ('REIT Regulations') during September 2014 with a view to provide a different type of asset class to the public investors. For the success of any new investment asset, especially where such asset is meant for public investors, clarity on taxation of income (i) of such investment vehicles and (ii) of investors in respect of the income from such vehicle plays a very critical role in attracting investor interest. Appreciating the importance of the role played by taxation, in the case of Real Estate Investment Trusts ('REITs'), a special tax regime was announced *vide* Finance Act 2014, even prior to the introduction of the REIT Regulations.

There have been continuous attempts to clarify and provide for additional concessions in the subsequent finance budget announcements in 2015 and 2016 as well to make REIT structure more acceptable from a tax perspective.

In this chapter, we will be discussing the direct tax implications on the REIT and the investors in respect of income from holding units of a REIT along with the relevant reporting requirements under the Income-tax Act, 1961 ('Act').

Before we proceed to discuss the direct tax implications, let us recapitulate on how a typical REIT structure works, brief explanation in respect of some key concepts relevant in this context, the possible investments by REITs and streams of income that a REIT and its investors would earn.



A. Some key concepts

- **REIT:** REIT is set up as a trust and is registered with SEBI under the REIT Regulations
- **Special Purpose Vehicle ('SPV'):** Holds the real estate properties and is engaged in incidental activities. SPV is held by REIT directly or through a Holding Company.
- **Holding Company ('HoldCo'):** Holds shares or interest in SPV and is in turn held by a REIT.
- **Unit holders:** Investors (including Sponsors) who hold REIT units. Unit holders could be either resident or non-resident unit holders. The units are required to be listed on a stock exchange.
- **Sponsor(s):** Who set(s) up the REIT and is designated as such at the time of application to SEBI. Sponsor is mandated to hold minimum prescribed stake of the REIT units.
- **Real Estate property:** Real estate properties that a REIT is permitted to hold directly or through SPVs.

Please refer to the Chapter Real Estate Investment Trusts – An overview for more details.

B. Nature of investments by REITs

As you may have noted from the Chapter on ***Real Estate Investment Trusts – An overview,*** as per the REIT Regulations, REITs are permitted to make investments in the following:

a) Equity share capital, other securities or interest in HoldCos or SPVs, which could be incorporated either as companies or Limited Liability Partnerships ('LLPs'); or

b) Directly in completed and income generating properties.

c) Under-construction/non-rent generating properties[1],

d) Listed and unlisted debt of companies or body corporates in real estate sector;

e) Mortgage backed securities;

f) Equity shares of listed companies which derive atleast 75% of operating income from real estate activities;

g) Government securities;

h) Unutilised FSI of a project where investment is already made;

i) TDR acquired for the purpose of utilization with respect to a project where it has already made investment; and

j) Money market instruments or cash equivalents.

C. Nature of income earned by REIT and the Unitholders

From the above mentioned investments, REITs would earn several income streams:

1. Dividend Income distributed by HoldCo and/or SPVs
2. Interest Income on debt infused in HoldCo and/or SPVs
3. Rental Income from property held directly by the REIT
4. Gains on sale of:
   a) Property held directly by the REIT;
   b) Shares in HoldCo or SPVs;
   c) Other securities held by the REIT;
   d) Other assets held by the REIT;

1 Subject to prescribed conditions

5. Any other income (e.g. dividends from listed shares, income from debt securities, etc.)

From an income-tax perspective, for the unit holders, the income distributed by a REIT would be in the same nature and same proportion, as if the unitholder had made the investment directly. Thus, the unit holder will also earn the above mentioned income streams. Separately, the unit holders will also hold REIT units and therefore, will earn gains on sale of such units.

D. Direct tax implications on various income streams[2]

Income earned by the REIT and distributed to its unitholders

The Act provides for a special tax regime for the REITs, Sponsors and other unit holders in the REITs. The tax regime provides for a complete exemption for certain dividend income and a single level tax for other sources of income in most cases. Tax is imposed on the income either at the REIT level or at the unit holder level through a partial tax pass through regime. The REITs are required to deduct tax at source where the income is pass through and is taxable in the hands of the unit holders therein.

We have discussed direct tax implications in detail in the subsequent paragraphs:

1. Dividend Income distributed by HoldCo and/or SPVs to the REIT

   Taxability of such dividend can be divided into the following baskets:

   (a) Where the REIT directly holds 100% equity shares in SPV (excluding equity shares mandatorily required by government or regulators to be held by other persons) and the dividend is distributed out of profits accrued after the acquisition of SPV by the REIT

   The Act provides a complete exemption in respect of such dividends.

   Accordingly, the SPVs distributing such dividend are not subject to dividend distribution tax ('DDT') so long as the dividend is distributed out of the income for the period beginning the date on which the SPV was wholly acquired by the REIT. Further, such dividend is specifically exempt in the hands of the REIT and its unit holders.

   Further, the REIT is not required to deduct any tax at source on the amount distributed out of such dividend to its unit holders.

   (b) in other cases, i.e. the REIT does not hold 100% of the SPV shares[3] or where dividend pertains to accumulated profits upto the date on which the SPV is acquired by the REIT or the REIT holds the SPV through a HoldCo (irrespective of % ownership):

   Dividend distributed by SPVs is subject to DDT at 15% and dividends have to be grossed up for applying this rate.

2 All tax rates in the Chapter (except dividend distribution tax) are exclusive of applicable Surcharge and Health and Education cess of 4%

3 Excluding equity shares mandatorily required by government or regulators to be held by other persons

For the HoldCo, such dividend is exempt from taxation. When the HoldCo distributes dividend, it is also liable to pay DDT. However, in computing the amount of dividend which would be liable to DDT, dividend received from SPV in the same financial year can be reduced from the dividend being distributed by the HoldCo[4] and therefore, there will not be any double taxation to that extent.

For the REIT, such dividend received from SPV/HoldCo is exempt. However, such dividend received by a REIT may be subject to additional tax at 10% where aggregate of such dividend exceeds INR 10 lakh during a particular year.

The REIT is not required to deduct any tax at source on the amount in the nature of dividend distributed to unitholders.

For the unitholders, such dividend would be exempt.

2. <u>Interest Income on debt infused in HoldCo or SPVs to the REIT</u>:

(a) Where the SPV is set up as a Company and is held by the REIT:

The REIT would be exempt from tax on such interest income, instead the unitholders would be taxable on such income.

The REIT would be required to deduct tax at source at 10% in case of resident unitholders and at 5% in case of non-resident unitholders on distribution of such income.

Unitholders are taxable at applicable rates in case of resident unitholders and at 5% in case of non-resident unitholders. Unitholders will be eligible to claim credit for taxes deducted at source by the REIT.

(b) Where the SPV is set up as a LLP:

The REIT would be taxable in respect of such interest income at Maximum Marginal Rate ('MMR'), i.e. 30%; however, the unitholders would be exempt from tax in respect of distributions out of such income. Accordingly, there is no requirement of deducting any tax at source on distribution out of such income by the REIT.

(c) Where SPV is held by a HoldCo:

The HoldCo will be taxable at the applicable rates on the interest income. Assuming that the HoldCo in turn would be paying interest to the REIT, the HoldCo may claim a deduction of interest payable to the REIT while computing its income.

4 Section 115-O and also that the HoldCo will hold atleast 51% of the equity shares of the SPVs as required under the REIT Regulations

Further, upon payment of interest by the HoldCo to the REIT, the tax implications for the REIT and the unitholders would be same as:

i. Point (a) above if the HoldCo is set up as a company,

ii. Point (b) above, if the HoldCo is set up as a LLP.

3. Rental Income from property held directly by the REIT:

Where a REIT owns any property directly, it may earn rental income from such properties. Such income is exempt in the hands of the REIT; however, the unit holders would be liable to tax in respect of such income.

The REIT is required to deduct tax at source on rental income distributed to the unit holders at 10% in case of resident unit holders and at rates in force [i.e. rate as per the Act or applicable rate as per relevant Double Taxation Avoidance Agreement ('Tax Treaty'), whichever is more beneficial] in case of non-resident unit holders. Unit holders are taxable at applicable rates in case of resident unit holders and at 40% in case of foreign companies and at applicable rates in case of other non-resident unit holders, subject of course to benefits under applicable tax treaty. Unit holders will be eligible to claim credit for taxes deducted at source by the REIT.

4. Gains on sale of property/securities held directly by the REIT:

Gains on sale of properties and securities are taxable for the REIT and are exempt in the hands of the unit holders. Further, upon distribution, the REITs are not required to deduct tax at source on such income.

a) On sale of property:

Tax computation on sale of property will be vary depending on the position taken by the REIT on whether the same constitutes a fixed asset or an investment.

If the property is regarded as an investment, the transfer of same would result in capital gains for the REIT. Given that the REIT Regulations mandate a REIT to hold any property for a minimum of 3 years, which is more than the holding period required to qualify it as long term asset[5], the gains on sale of property would likely qualify as long term. Tax on such long term capital gain ('LTCG')[6] would be computed at 20%.

If the property is regarded as fixed asset, while the tax treatment for land would be same as above, i.e. LTCG taxable at 20% (since most likely it will qualify as long term), the building would constitute as depreciable asset. Therefore, the capital gain upon sale of building will be determined basis the specific computation mechanism prescribed for depreciable assets. Such gains would arise only if all the buildings (in same block) are sold or the

5 Immoveable property held for a period of more than 24 months qualify as long term as per section 2(42A)

6 Adjustment for Cost Inflation Indexation permitted

written down value of the block of buildings becomes nil. Such gains, irrespective of the holding period, would always be taxable as short term capital gains ('STCG') at applicable rates.

b) On sale of shares in the HoldCo or the SPVs:

Given the restriction under the REIT Regulations mandating REITs to hold properties (directly or through HoldCo or SPV) for a minimum period of 3 years, typically the shares in HoldCo or SPVs would also be held for 3 years and therefore would likely qualify as long term capital asset[7].

i. If the shares are listed:

LTCG would be taxed at 10% (without indexation) subject to securities transaction tax ('STT') being paid at the time of acquisition (or where the purchase is through one of the proposed notified modes) and on transfer.

In case the STT conditions are not met, the LTCG would be taxed at lower of 20% with indexation and at 10% without indexation.

ii. If the shares are unlisted:

LTCG would be taxed at 20% (with indexation).

c) On sale of other securities:

Similar to the above, income on sale of debentures will be taxable for the REIT as capital gains at 20% (without indexation) if long term (i.e. held for more than 36 months) and at applicable rates if short term (i.e. held for 36 months or less) in nature.

In respect of capital gains on sale of listed shares, the REIT will be taxed at 10% (without indexation) if long term[8] (i.e. held for more than 12 months) and 15% if short term (i.e. held for 12 months or less) in nature.

d) On sale of other assets:

Income on sale of other assets (assuming held as investments) will be taxable for the REIT as capital gains at 20% if long term (i.e. held for more than 36 months) and at applicable rates 30% if short term (i.e. held for 36 months or less) in nature.

5. <u>Any other income earned by the REIT:</u>

The REIT will be taxable at MMR in respect of any other income (except dividend income from listed companies). Such income would be exempt for the unit holders.

Dividend income from listed companies is exempt for the REIT. However, the REIT may be subject to additional tax at 10% in case the aggregate of such dividend exceeds INR 10 lakh during a particular year. Unit holders are exempt from tax on such dividend.

7 Unlisted shares held for a period of more than 24 months qualify as long term as per Section 2(42A) of the Act

8 Section 112A. 10% tax rate is available subject to STT being paid at the time of acquisition (or where the purchase is through one of the proposed notified modes) and sale of listed shares

There is no requirement for the REIT to deduct tax at source on distribution of such income.

Income earned by the unit holders

6. <u>Income on sale of the REIT units by unit holders</u>:

REIT units are mandatorily required to be listed on a recognised stock exchange. Assuming that the unit holders hold the REIT units as capital assets, gain upon sale of such units would be taxable as capital gains at 10% if held for long term (i.e., more than 36 months) and 15% if held for short term (i.e., 36 months or less) provided STT is paid at the time of transfer. No indexation benefit is available for the computation of long term capital gains and in case of non-resident unit holders, foreign exchange fluctuation benefit is also not available for the computation.

However, in case, no STT is paid on transfer, the gains will be taxable at lower of 20% with indexation and at 10% without indexation[9], if held for long term and at applicable rates if held for short term. In this case, while indexation benefit is available, foreign exchange fluctuation benefit is not available for non-resident unit holders.

Additionally, for non-resident unit holders, the applicable tax treaty would need to be analysed as some tax treaties provide for exemption on capital gains on sale of instruments other than shares of Indian companies.

Further, in case the unit holders (except the Sponsors) are subject to Minimum Alternate Tax ('MAT') [i.e., companies (other than foreign companies which do not have a permanent establishment in India], the gains on sale of the REIT units would be included in the computation of book profits for the purposes of computing MAT at 18.5%.

E. Tax implications for Sponsor

Special tax treatment has been prescribed in connection with transfer of shares in SPVs (in the form of companies) by a Sponsor to a REIT sponsored by it.

Sponsor is exempt from direct tax upon transfer of shares of such SPVs formed as companies to the REIT in exchange of units in the REIT. Further, any notional gain or loss upon exchange of such shares of SPVs for units in the REIT if recorded in the books of the Sponsor is excluded from the book profit for the purposes of computing MAT for Sponsor.

However, the cost and the acquisition date of the units so allotted to the Sponsor would be deemed to be the cost of acquisition and acquisition date of the REIT units for the Sponsor for computing capital gains on sale of such units. Further, the notional gain excluded in computing book profit at the time of contribution of the SPVs in REIT will be included in the book profit of the year in which the units are sold.

However, similar relaxation is not provided where the Sponsor intends to transfer (a) shares of HoldCos or (b) interest in SPVs set up as LLPs or (c) properties directly to the REIT in exchange of REIT units or intends to transfer any of the assets in exchange of cash. Thus, any transfer of these assets would attract tax for the Sponsor upon transition and the Sponsor would also be required to pay tax upon actual exit by sale of the REIT units. Upon transfer of the assets to the REIT, Sponsor would be subject to tax on the gains depending upon the period of holding, i.e., LTCG at 20% if held for more than 24 months and STCG at applicable rates if held for 24 months or less.

9 Differing view on applicability of 10% rate for REITs since REITs are specifically not included in the definition of securities as per Securities Contract (Regulation) Act, 1956

F. Some other aspects

1. Payment of interest on moneys borrowed by the REIT

REITs are permitted to borrow funds from domestic as well as offshore sources. REITs need to deduct tax at source on interest payable:

(a) to resident lenders at 10%

(b) to non-resident lenders or foreign company at 5% if prescribed conditions are satisfied and at rates in forces in other cases.

2. Deduction of expenses at the REIT level

REITs typically incur interest on borrowings made by REITs, management fees, audit expenses, trustee fee, valuer fees, and other operating expenses. It will be important for the REIT to evaluate the deductibility of such expenses against the various income streams for the purposes of tax computation at the REIT level. Further, the REIT will also need to allocate the expenses amongst the several income streams some of which are pass through and the rest are taxable at the REIT level.

3. Deduction of expenses for tax deduction at source ('TDS')

REITs are also required to deduct tax at source on distributed income being in the nature of rental income or qualifying interest income. However, in the absence of definition of the term 'distributed income', REITs would need to consider whether the tax needs to be deducted on (a) gross income, or (b) income net of all expenses of the REIT or (c) income net of tax deductible expenses incurred at the REIT level.

G. Income-tax reporting requirements by REITs

Some key reporting requirements applicable to REITs are:

1. Statement of income distributed by the REIT

With respect to the income distributed to each of its unit holders, every REIT is required to furnish a statement:

(a) To the unit holders, in the prescribed form[10] by the 30th June of the relevant Assessment Year ('AY'); and

(b) With the income-tax authorities in the prescribed online form[11] verified by a Chartered Accountant by the 30th November of the relevant AY.

2. Income Tax Return ('ITR')

REITs are required to file the details of their respective total income and the tax payable in the prescribed ITR form by the 30th September of the relevant AY. Where transfer pricing provisions are applicable, the due date for ITR filing will be 30th November of the relevant AY.

The unit holders[12] are also required to report the income earned from the REIT in their respective ITRs by the applicable due dates.

3. Transfer Pricing

In case of international transactions with associated enterprises, a REIT is also required to evaluate the applicability of the transfer pricing provisions and

10 Form 64B verified by the person distributing the income on behalf of the REIT

11 Form 64A

12 Where the total income of a non-resident unitholder consist of only interest income regarded as pass through and where REIT has deducted tax at source at 5% on such interest, such unitholder is not required to file income-tax return

accordingly ensure the electronical filing of the Chartered Accountant's report in the prescribed form by the 30th November of the relevant AY.

Further, a transfer pricing study is required to be maintained by the REIT.

4. FATCA

The REIT is required to identify its non-resident unit holders after conducting necessary due diligence and comply with the FATCA reporting requirements in the prescribed form by the 31st May subsequent to the calendar year end at 31st December

5. Reporting for payments to a non-resident

In respect of any payment to a non-resident, the REIT is required to furnish details of the income being remitted along with the TDS, if any. Such reporting in the prescribed form is supported by a Chartered Accountant certificate in a separate form.

6. TDS returns and TDS certificates

The REIT is also required to file quarterly TDS returns and thereafter generate TDS certificates electronically of all the taxes deducted at source.

H. Way forward

From the above, it is clear that the Act grants preferential tax treatment for the REITs. However, there are still some creases which could be ironed out. Some of the key industry recommendations from a direct tax perspective are:

— While REIT Regulations permit two layered structure i.e., HoldCo-SPV, tax pass through is presently available only for single layered structures (i.e. where the REITs own the SPVs directly) and not available for such two layered structures and should be extended.

— Sponsors have been provided for tax deferral (both capital gains and MAT) upon transfer of the SPV shares to the REIT till the actual exit by way of sale of the REIT units. The tax deferral provisions should also cover transfer of properties directly to the REIT.

— Pass-through on interest income from SPVs set up as LLPs should be extended on lines with that available to SPVs set up as companies.

— While listing of the REIT units afford easy liquidity, the requirement to hold the REIT units for a minimum of 36 months to qualify for lower tax rate acts as a dampener. Similar to listed equity shares, the holding period of the REITs should be reduced to 12 months for qualifying as long term and be eligible for a lower tax rate of 10%.

— In the absence of tax pass-through for capital gains on sale of shares or debentures of HoldCo/SPVs, the entire gains (typically long term) suffer tax at 20%. In case of non-resident unit holders, the applicable tax rate on LTCG is 10%[13] under the Act and some tax treaties also provide for exemption on capital gains on sale of debentures. REITs should be made a complete tax pass-through vehicle instead of the partial pass-through.

Albeit the tax pass-through provided to REITs is partial, the attempt has been to avoid double taxation on account of an investment vehicle structure. Overall, the tax treatment granted to the REITs coupled with a clearly defined regulatory platform does offer a lucrative investment opportunity for investors to enjoy the returns offered by the real estate sector at a low ticket size and with easy liquidity as against investments in physical real estate properties.

13 Without indexation

CA Niren Shethia, CA Parag Chavan & CA Ritesh Mehta

Real Estate Investment Trusts Indirect Tax – Key Provisions

India witnessed implementation of one of the most anticipated indirect taxation reform, Goods and Service ('GST') with effect from 1st July 2017. The introduction of GST is a very significant step in the history of Indian indirect taxation which not only transformed the indirect tax structure but also necessitated (in most cases) business transformation/reassessment.

GST amalgamated a large number of central indirect taxes (such as, central excise duty, service tax, certain custom duty components, etc.) and state indirect taxes (such as, State value added tax ('VAT'), entry tax, etc.) into a single tax, i.e., GST.

The primary objectives behind GST implementation was to create single tax layer mechanism, to reduce the cascading effect of the taxation by expanding the scope of input credits paid on procurements and expand the base for taxation by reducing the exemptions/ exceptions.

Principally, GST is destination based tax on consumption of goods and services. India has adopted a dual GST structure in line with its federal mechanism - the Centre and States both have powers to levy GST on goods/services.

The GST regulations also provide for unique place of supply provisions which are relevant from the perspectives of (i) which GST will apply, and (ii) which State would get the revenue from the transaction.

Real Estate Investment Trust (REIT) is a recent phenomenon and has been introduced by Securities and Exchange Board of India (SEBI). It is coined with the objective of inviting investments, liquidating real estate assets, availability of funds, etc. and in this process getting real estate prices under control.

Since the subject matter for REITs is real estate, prior to understanding the tax implications on REITs, it is apposite to learn in brief the tax treatment for the real estate sector.

History under service tax and VAT (for real estate sector)

The real estate sector has a history of challenges faced under the Indian indirect taxes due to peculiar nature of the business; the biggest challenge had been whether the (erstwhile) indirect tax (service tax and / or VAT) applied on the transaction or the transaction resulted in an immovable property and hence, indirect tax did not apply.

The Courts had laid down certain principles for taxing transactions for real estate sector:

- If the transaction was of an immovable property, no service tax/ VAT would apply (i.e., where transaction was done post obtaining completion certificate (CC));

- For other cases, the dispute on characterisation of the transaction as that of goods or service had been settled and resultantly, the applicability of both taxes, service tax and VAT, was accepted.

The tax cost impact was felt by the sector due to dual taxation (service tax and VAT) and restriction in credits, although certain deductions/ valuations norms were prescribed to avoid the same tax base being taxed under both laws.

Therefore, the real estate sector was looking forward for implementation of the GST.

Treatment under GST (for real estate sector)

The GST law has settled the dispute on the characterisation of the transaction as that of goods or services; the transaction in real estate is considered as a service (in line with the global principles).

The GST regulations also provides for different tax rates in relation to construction activities ranging from 5% to 18%.

While most of the exemptions and concessions were grandfathered by the lawmakers from the erstwhile tax regulations, certain additional aspects were also clarified under the GST regime. The list of some of the welcoming provisions are mentioned below:

- Like the erstwhile indirect taxation regime, land is still outside the purview of GST (although the sector has been demanding that the land is also brought within the GST ambit).
- No GST on sales after issuance of CC (or first occupation).
- Concessional tax rates to promote certain nature of projects (e.g., affordable housing projects).
- Exclusion of land value with a cap of one third value of the total amount.
- Anti-profiteering provisions[1] to ensure tax benefits are passed to buyers.

GST impact on REITs

A REIT is set up as a trust, in which investors invest monies against which investors are issued units. Such investment allows units holders to earn income without commercially owning such assets (through a Special Purpose Vehicle (SPV) or a holding company) in addition to derisking for particular property/asset.

Typically, following players exist in a REIT structure:

- <u>Sponsor</u> – A sponsor is a person who holds the real estate assets and who sets up a REIT.
- <u>Investors (unit holders other than sponsor)</u> - Persons who invest into the REITs by way of subscriptions to units issued by REITs.
- <u>REITs</u> – REITs are trust created with objective of distribution of income generated by them to its unit holders.
- <u>Trustee</u> – Trustee manages the REITs and acts on behalf of unit holders to oversee the operation of the REIT.
- <u>Manager</u> – The role of manager is to manage assets and investment and undertake the operational activities.
- <u>Holding company</u> – REITs may operate through holding company which subsequently holds securities in SPV. The assets are held by an SPV.
- <u>SPV</u> – REITs may also operate through an SPV directly which holds the assets.

REITs can either hold the assets directly or operate through an SPV model. Generally, the former may not be implemented due to factors such as stamp duty on asset transfer, risk coverage/ring fencing the risk in specific SPV assets.

1 Anti-profiteering measures ensure that benefits accrued to the sector (in terms of additional credits or lower tax) must reach the ultimate consumers.

GST implications

Sr. No	Name of party	Nature of income	Taxability under GST
1.	Sponsor	Transfer of the shares of SPV for units of REITs	• Transactions in securities are not taxable and accordingly barter of shares *vis-à-vis* units should be outside the GST net.
		Transfer of real estate assets for units of REITs	• Although practically, REITs may not directly hold the assets, however, if there is transfer of assets then it shall attract GST depending upon the stage of transfer ie under construction or post construction.
		Sale of units of REITs	• As mentioned above, securities are outside the ambit of GST and accordingly will not attract GST.
2.	Investors (unit holders)	Interest/ dividend received and profit on sale of units / securities	• Income by way of dividend/ interest/ profit on sale of units / securities earned by the investors will not be subjected to GST due to either its exclusion or being not covered by the GST law.
3.	REITs	Sale of assets	• Implications would be similar in lines with as mentioned for transfer of assets by sponsor.
		Interest / dividend received and profit on sales or redemption of securities in SPV	• Same as discussed above.
4.	Trustee	Fees for managing activities of REIT	• The Trustee may receive certain fees for the management services provided by it. Such management fees will be subjected to GST.
5.	Manager	Fees for management of assets	• The management fees earned shall be liable to GST.
6.	Holding company	Interest / dividend	• Same as discussed above.
7.	SPV	Rental income [other than properties located in Special Economic Zone (SEZs)]	• An activity in the nature of leasing, letting out, renting of immovable property is considered as 'supply of services' under GST regulations. Accordingly, rental income earned will be taxable under GST regime. • In terms of place of supply rules, the place of supply in relation to immovable property is the location of such property. • When SPV invests in an under construction property, GST will apply on such transfer. If SPV sells such property which is being constructen, SPV will need to charge GST on such sale and set off of GST paid by the SPV to the developer will be available. • On the other hand, where SPV leases out the property after completion of construction, due to specific exclusion from the eligibility of credit, the GST paid on acquisition of under construction property will therefore become cost to SPV.
		Rental income (from properties in SEZs)	• Rental from SEZs will be considered as 'zero rated supply' under the GST regulations and therefore no GST will apply, subject to conditions prescribed under the GST laws. Ambiguity prevails on the nature of tax to be levied ie IGST or CGST + SGST.
		Sale of assets	• The major portion of the assets will constitute immovable properties. Sale of immovable properties is outside the ambit of GST. Accordingly, such assets will not be subjected to GST.

Registration requirements

As per GST regulations, every person is required to obtain registration in a State from where it makes a taxable supply. The registration requirement under GST is a state-wise requirement (akin to registration requirements under the erstwhile VAT regime).

However, the GST law provides a relaxation to the persons who are engaged exclusively in the business of supplying goods/ services that are not liable to GST or exempted under GST, from the registration requirement.

Consequently, if the income earned by it is in the nature of dividend/ interest/ profit on sale of shares/ redemption on debentures, the parties will not be required to be obtain registration under the GST.

However, if the SPVs earn a rental income through assets, then SPVs would need to obtain the GST registration (if the rental income exceeds INR 20 lakh in a financial year); since the place of supply for such rental income would be the location of the property, the SPVs will be required to obtain registration in the state where the property is located. Such requirement will, however, increase the compliance burden adding to cost for business.

Reporting in GST returns

GST regulations prescribe for a State-wise reporting. Currently, a taxpayer is required to file (2) GST returns on a monthly basis; these returns are GSTR-1 and GSTR-3B.

GSTR-1 captures the revenue details at an invoice level, while GSTR-3B captures details of revenue and expenses at a summary level.

If SPVs earns a rental income, it will have to disclose the revenue details; further, it will also need to disclose the interest income (if earned) as exempt income. Currently, there is no clarity on disclosure of income from the securities like dividend on shares/ interest on debentures.

The returns are to be filed on the GST portal. The implementation of GST was expected to ease the compliance burden for the industry; however, the multiplicity of the returns coupled with infrastructure inability has increased the efforts to undertake compliances in GST.

Therefore, considering the difficulties faced and the representations made by various sectors to Government, the Government has announced a roll-out of the simplified return filing process which is expected to be implemented towards the second half of the FY 2018-19.

Conclusion

REITs exists globally and its success is dependent upon the regulatory framework and tax breaks offered by the Government. Considering that REITs are at a nascent stage of development in India and hence it needs significant support. In order to achieve the objective to attract investments in this sector, it is essential that the Government should consider exempting GST on under construction asset transfers by the Sponsor or allow credit of the tax paid such that it can be utilised against future GST liabilities on rental income. Similarly, the Government could also consider granting stamp duty exemptions such that it does not become a road block for operating REITs.

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First build up your physique. Then only you can get control over the mind.

— *Swami Vivekananda*

Dr. Anup P. Shah, *Chartered Accountant*

Infrastructure Investment Trusts – An Overview

Overview and Concept

Infrastructure Investment Trusts or **InvITs** are a popular way of monetising infrastructure projects, such as, roads, power plants, toll bridges, ports, etc. Internationally, InvITs have been recognised as an excellent value unlocking tool for infrastructure projects. The concept broadly works as follows:

(a) An infrastructure developer usually owns his income-generating assets in a company/Special Purpose Vehicle **(SPV)**

(b) A Trust is set up which is known as a InvIT. The developer usually sponsors the Trust. A professional manager is appointed for the InvIT.

(c) The InvIT makes a public issue of its units to various investors and raises funds. An InvIT is regulated by the SEBI.

(d) These units are listed on a stock exchange in India.

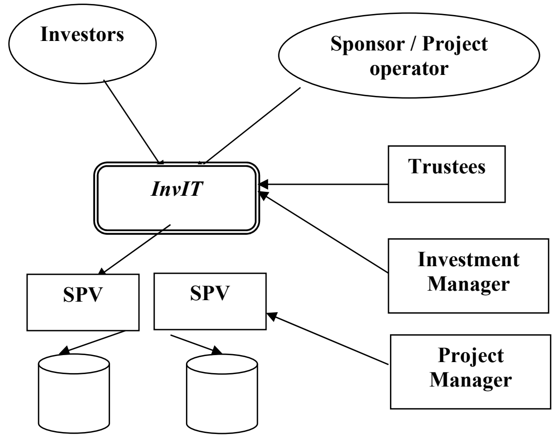
(e) The InvIT acquires the infrastructure assets from the operator by acquiring shares in the company **(SPV)** owning such assets. InvITs invest in fully operational income-generating assets, e.g., a toll road. Hence, the risk element associated with investing in under construction projects is done away with.

(f) The InvIT earns income in the form of operational income from its projects which is then distributed amongst the unit holders.

(g) The InvIT provides an excellent exit route to the infrastructure player.

(h) For an investor it is a good opportunity to get into infrastructure projects. Thus, he gets the benefits of a portfolio without the high risk element associated with it. Further, since the InvIT is regulated and also governed by Trustees, the corporate governance element is also very high.

A InvIT may be diagrammatically explained as follows:



For instance, the first publicly listed InvIT in India is a fund which holds shares in several SPVs, each owning income-generating toll road projects across India. All of these shares have been acquired by the InvIT from the Sponsor. An investor could have either invested in the IPO of the units made by the InvIT or by buying the listed units on the floor of the stock exchange.

Each project SPV distributes, on a half-yearly basis, at least 90% of its net distributable cash flows (which consists of the post-tax cash flows generated from the projects + net of tax proceeds from the sale of assets, both after repayment of debt and interest) to the InvIT.

The InvIT, in turn, would utilise this cash flow received by it from the SPVs, to distribute at least 90% of the same to the unit holders. Thus, the unit holders get a recurring cash flow.

SEBI Regulations

In India, InvITs are regulated by the SEBI which has issued the ***SEBI (Infrastructrue Investment Trusts) Regulations, 2014.*** The salient features of these Regulations are as follows:

(a) InvIT's structure

The InvIT shall be set up as a Trust under the provisions of the Indian Trusts Act, 1882. The key parties for a InvIT shall be a SEBI registered trustee, a sponsor, and an investment manager. A InvIT must make an application to the SEBI for getting registered with it. It must also have a project manager who would be responsible for executing/managing the project.

The sponsor sets up the InvIT and appoints the Trustee. Normally, a large infrastructure developer is the sponsor and he sets up a InvIT as a means of exiting his portfolio. The term "infrastructure" has been defined to include all infrastructure sub-sectors, such as, roads, bridges, ports, airports, waterways, energy generation/transmission/distribution, solid waste management, water treatment plants, telecom, schools, hospitals, certain hotels, cold chains, etc.

The sponsor must have a net worth of at least ₹ 100 crore if it is a body corporate/company and net tangible assets of at least ₹ 100 crores in case it is an LLP. Further, the sponsor must hold not less than 15% of the total units of the InvIT after the IPO for a period of 3 years from the date of listing. Any holding above 15% must be held for 1 year from the date of listing.

(b) IPO and Listing

Once registered, the InvIT may raise funds through an initial public offering of its units or a private placement. Hence, in this respect a InvIT is similar to a mutual fund since both raise funds by issuing units. However, unlike a mutual fund, a InvIT does not have the option of whether or not to list its units. Listing of units is compulsory for all InvITs, whether it raised funds publicly or privately.

The InvIT must have an asset base of at least ₹ 500 crore before it can make an IPO. This is to ensure that marginal and fringe players are weeded out. The initial offer size must be of at least ₹ 250 crores. The minimum offer size (excluding issue to the sponsor and related parties) must be:

(i) At least 25% of the total units if the post-issue capital is less than ₹ 1,600 crores;

(ii) At least ₹ 400 crores if the post-issue capital is more than ₹ 1,600 crores but less than ₹ 4,000 crores; and

(iii) At least 10% of the total units, if the post-issue capital is more ₹ 4,000 crores.

The minimum number of unit holders in case of a public issue of units shall be 20 each holding no more than 25% of the units whereas in case of a private placement of units, the number is 5 each holding no more than 25% of the units.

(c) Investors

InvITs can raise funds from any investors, whether resident or non-resident, domestic or foreign. Currently the minimum subscription under a public offer has been kept at a size of ₹ 10 lakhs per investor and the trading lot for purpose of trading of publicly offered units has been kept at s size of ₹ 5 lakhs but the trading lot for purpose of trading of privately placed units has been kept at s size of ₹ 1 crore.

(d) Investment by the InvIT

The InvIT must mainly invest in infrastructure projects. Not less than 80% of the value of InvIT assets shall be invested, in completed and revenue generating infrastructure projects. The balance 20% can be invested in under-construction infrastructure projects, securities of infrastructure companies, certain other investments.

An "eligible infrastructure project" means an infrastructure project which, prior to the date of its acquisition by, or transfer to, the InvIT, satisfies the following conditions–

(i) For Public Private Partnership (PPP) projects,– (1) the Infrastructure Project is completed and revenue generating project, or it has achieved commercial operations date and does not have the track record of revenue from operations for a period of not less than one year, or it is a pre-Commercial Operation Date (COD) project;

(ii) In non-PPP projects, the infrastructure project has received all the requisite approvals and certifications for commencing construction of the project.

A "completed and revenue generating project" means one which has received all approvals, achieved the COD and has been generating revenue from operations at least for 1 year.

InvITs can invest either:

- In the projects directly; or
- Through special purpose vehicles, wherein such special purpose vehicles (SPV) hold not less than 90% of their assets directly in such projects. However, in such cases, it has been mandated that InvIT shall have control over the SPV.

Detailed provisions have been laid down for related party transactions with the sponsor, etc. These include provisions for unitholders' approval (other than by the sponsor and his associates voting), independent valuations, disclosures, etc.

InvITs can also borrow up to 49% of the value of the InvIT assets.

(e) Manager/Trustees

Like a mutual fund, there would be a professional investment manager to take investment decisions with respect to the underlying assets of the fund and a board of trustees who would oversee compliance by the InvIT. The manager must have:

(i) A net worth of at least ₹ 10 crore;

(ii) Minimum 5 years of experience in fund management/advisory services or development in the infrastructure sector; and

(iii) At least 2 key personnel in its Investment Committee who each have not less than 5 years of the aforesaid experience.

(f) Payout Policy

An SPV must distribute at least 90% of the net distributable cash flows to the InvIT. An InvIT, in turn, must distribute at least 90% of its net distributable cash flows to its investors. Such distributions must be declared and made at least once in every 6 months a year. If any property is sold by a InvIT or its SPV or shares are sold by the InvIT in a SPV, then unless the same are reinvested or are proposed to be reinvested within 1 year, then at least 90% of the same shall be distributed.

(g) Valuation

The key to a mutual fund is the Net Asset Value or NAV of its unit. The same is the case with a InvIT. However, unlike securities and shares, infrastructure assets are not easy to value. A full valuation of the InvIT's assets must be conducted by the principal valuer at least once a year and the full valuation report shall be included in the Annual Report provided to the unit holders. A full valuation includes a detailed valuation of all assets including physical inspection of every asset by the valuer. In addition, a half yearly valuation of the assets shall be conducted by the valuer not less than once every six months for incorporating any key changes in the past six months.

A valuation is also required to purchase or sell a project by the InvIT. The purchase price can be @ maximum 10% premium to the valuation while the sale price can be @ maximum 10% discount to the valuation. Any higher purchase price or lower sale price would require the approval of the unitholder. Further, any purchase from/sale to a related party must follow specific valuation procedures.

Any valuation undertaken by any valuer shall abide by international valuation standards and valuation standards as may be prescribed by Institute of Chartered Accountants of India (ICAI) for valuation of infrastructure assets.

Further, the valuer must be rotated to ensure that the same property is not valued by one valuer for more than 4 years.

FEMA Provisions

The ***Foreign Exchange Management (Transfer or Issue of any Security to a Person Resident Outside India) Regulations, 2017*** expressly permits foreign investment in the units of a InvIT by a person resident outside India. However, a citizen of Pakistan/Bangladesh is ineligible to do so. Further, if the Sponsor, Investment Manager and the Asset Manager of such a InvIT are owned and controlled by Indian citizens, then the entire investment made by the InvIT in SPVs is treated as domestic investment. However, if they are either owned or controlled or owned and controlled by non-residents, then the investment would be treated as indirect foreign investment. Further, a non-resident Indian can also invest in the units of an InvIT on a non-repatriation basis and the same would be treated at par with domestic investment by a resident Indian.

The ***Foreign Exchange Management (Borrowing or Lending in Foreign Exchange) Regulations, 2000*** also expressly permit a InvIT to raise foreign currency loans under Track II of the Regulations on long-term tenure with a minimum average maturity of 10 years. These could be in the form of loans, securitised instruments, non-convertible debentures, etc. The lenders could be foreign banks, financial institutions, overseas long-term investors, etc. However, overseas branches and subsidiaries of Indian banks are ineligible lenders.

Others

One of the hurdles still prevailing is that there are no Stamp Duty concessions for introduction in the InvIT of shares of SPVs/assets by the developer. As the law stands today, any exchange of shares of SPVs for units of the InvIT would attract stamp duty as an Exchange on the higher of the market values of the two assets.

Conclusion

InvITs are an excellent concept which would provide a much needed boost to the commercial real estate industry. Countries, such as, Singapore have become the hot favourite for listing of InvITs and given a favourable tax and regulatory regime, there is no reason why India cannot be one. Several large funds are waiting in the wings for the decks to be cleared for diving deep into the InvITs space. Although a few niggles yet remain, a lot of spadework has been done. Let us hope that InvITs to provide the much needed liquidity to what are otherwise illiquid assets!

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CA Naresh Makhijani, CA Sagar Palnitkar & CA Nirmal Nagda

Infrastructure Investment Trusts Direct Tax – Key Provisions

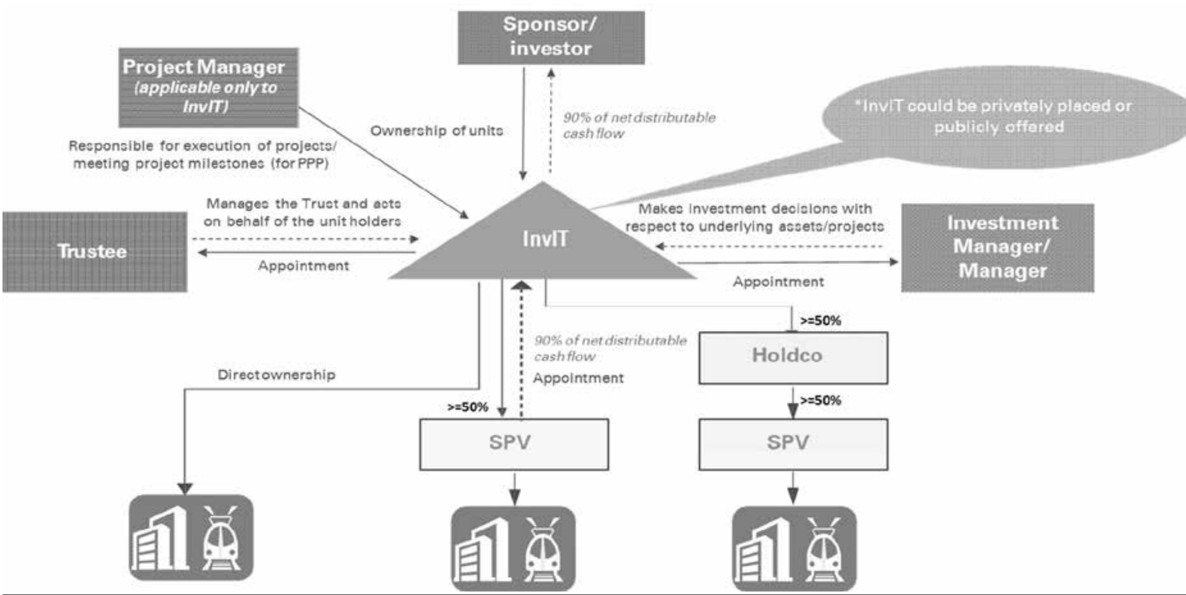
India's physical and geographical features necessitate extensive investment in infrastructure. Because of this determinant, there is a role not only for Government-funded infrastructure projects, but also private-sector-funded infrastructure investment. A well-developed infrastructural set-up is indispensable to boost the overall development of the country. This is particularly true for India if it wants to double its economy to USD 5 trillion by 2025. Whilst several factors exist that would decide whether India would be able to build the infrastructure needed, ability to garner long-term finance is one of the most important factor. Further, the quantum of funding requirement for the Infrastructure sector is also massive - Economic Survey 2018 estimated that India needs USD 4.5 trillion by 2040 to develop infrastructure.

To meet the funding related needs of the sector, the Indian Government has been adopting various measures. One such measure is the newly introduced investment vehicle for infrastructure sector named Infrastructure Investment Trusts ('InvITs'). The capital market Regulator, The Securities and Exchange Board of India ('SEBI'), has rolled out regulations on InvITs effective 26th September, 2014. InvITs are intended to : (i) offer suitable platform for financing/refinancing infrastructure projects in India; (ii) broaden the investor base and allow the retail investors to take part in the growth story of infrastructure in India; (iii) reduce dependence on banks for funding; (iv) release of locked up capital in the existing infrastructural projects.

To make InvITs attractive, the Finance Act, 2014 introduced a specific taxation framework for InvITs. The basic intent of this is to give fiscally-transparent status to InvITs or to ensure only one level of taxation. There is continuous and conscious attempts to clarify and offer more concessions in the successive Union Budgets to make InvIT structure more attractive and workable from a tax perspective.

This chapter covers direct tax implications in the hands of InvITs and Unit Holders/ Sponsors. Further the reporting requirements applicable to InvITs have also been discussed in this article.

A typical InvITs structure



Key definitions

Sponsor: Sponsor is a person(s) who set(s) up the InvITs and contributes infrastructure projects to the InvITs. Sponsor must hold 15 per cent of total units of the InvITs.

Investors/Unit Holders: Resident and non-residents investors who hold units of the InvITs.

InvITs: Mean the trust registered under the SEBI regulations.

Special purpose Vehicle ('SPV'): A company or Limited liability partnership ('LLP') which holds infrastructure assets. InvITs holds at least 51 per cent of the equity share capital or interest of SPVs.

Holding Company ('Holdco'): A company or LLP which holds at least 51 per cent of equity share capital or interest of SPV. InvITs holds at least 51 per cent of equity share capital or interest of Holdco.

Regulatory framework

In terms of the SEBI regulations, an InvITs can make direct investments in infrastructure projects, or invest in Holdco/SPV owning Infrastructure projects. Further, the following investment guidelines apply to InvITs:

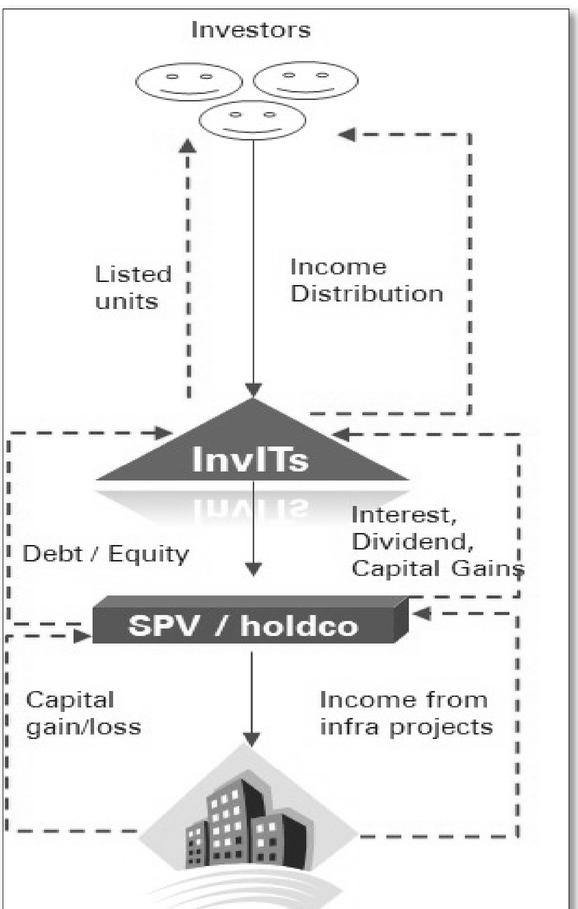
- At least 80 per cent of value of InvITs assets shall be invested in:
  - Equity share capital, debts instruments, other securities or interest in SPVs, or
  - Directly in completed and revenue generating infrastructure projects.
- Up to a maximum of 20 per cent of value of InvITs assets can be invested in:
  - Under-construction infrastructure projects;
  - Listed and unlisted debt of companies or body corporates in infrastructure sector;
  - Equity shares of listed companies which derive at least 80 per cent of operating income from infrastructure sector;

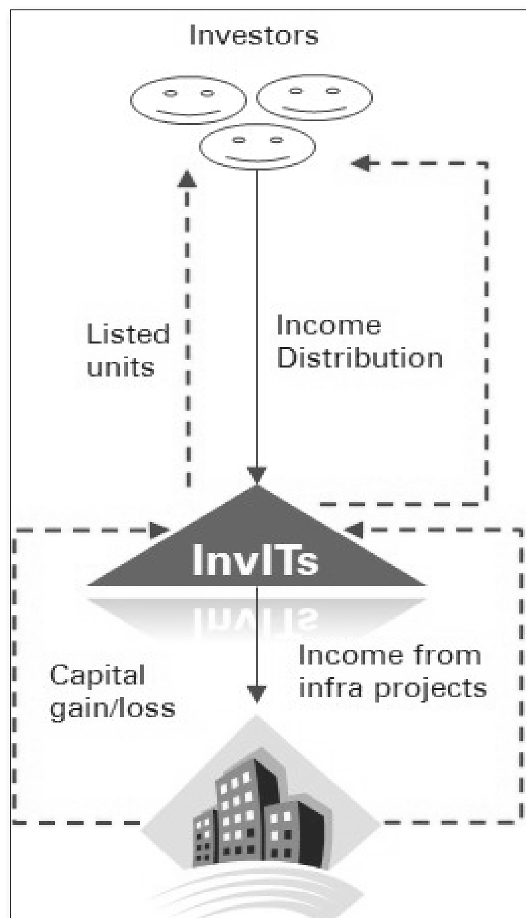
– Government securities; and
– Money market instruments, liquid mutual funds or cash equivalents.

Above investments would typically give rise to following income streams to InvITs:

- Direct investments:
  – Deemed income on purchase of Infra assets;
  – Income from operation of infra assets;
  – Capital gains on transfer of infra assets
- Investment through SPV/Holdco
  – Interest Income on debt infused in Holdco or SPVs;
  – Dividend Income distributed by Holdco or SPVs;
  – Capital Gains on transfer of shares of Holdco or SPVs
- Dividends from listed shares, business income, interest on debt securities, etc.

The above is explained in a diagrammatic representation format given below:





Taxation in the hands of InvITs

Taxation of InvITs is dealt by section 115UA of the Income-tax Act, 1961 ('the Act') read with section 10(23FC) of the Act. The taxability varies according to the nature of income earned by InvITs. Tax implications with respect to different revenue streams in the hands of InvITs are as follows:

(A) Direct Investment in InvITs

Deemed income on purchase of Infra assets:

Under section 56(2)(x) of the Act, any person who buys any immovable property (i.e., land and building) for a consideration lower than the fair value of such property, then he is taxed on the excess of the fair value over the consideration paid. Specific to InvITs, contrary to buying only land and building, it would generally buys a completed infrastructure project on 'going-concern' basis. So, arguably, it should escape taxation under the deeming fiction created under the Act.

Income from Infra assets

Income generated from the infrastructure assets is taxable in the hands of InvITs as income from business at maximum marginal rate ('MMR')[1], i.e. 30[2] per cent.

Capital gains on transfer of Infra assets

As per SEBI regulations, it is mandatory for the InvITs to hold infrastructure assets at least for three years from the date of purchase. The corporate tax rate on capital gains from transfer of infra assets held for over thirty six months (i.e. long-term capital gains) is 20 per cent[3].

(B) Investment through SPV/Holdco

Interest income

Contrary to Interest income received from the SPV (set-up as an LLP) taxable only in the hands of InvITs[4] at MMR, interest income received from the SPV (set up as a company) is taxable only in the hands of the Unit Holders upon distribution by the InvITs. Further, in the latter case, InvITs must withhold tax at the rate of five/10 per cent while distributing interest to non-resident investors and resident investors[5] respectively.

Dividend income

Dividends declared by SPVs are exempt in the hands of InvITs[6]. Further, SPVs wholly-owned by InvITs (excluding equity shareholdings mandatorily required by any extant law to be held by others) and the dividend is distributed out of profits accrued after the acquisition of SPV by the InvITs, do not suffer dividend distribution tax ('DDT')[7].

A relevant question arises if in case InvITs receive dividends in excess of INR 10 lakh in a year, could it be subject to additional 10 per cent tax on dividends[8]. While two views possibly exist, since such dividend is specifically exempt under section 10(23FC)(b) of the Act and in the absence of proviso similar to one inserted in section 10(34) of the Act, a better view should be such an additional tax should not apply on such dividend.

Capital Gains

Gains arising on transfer of any investments by InvITs is subject to tax as capital gains in

1 Section 115UA(2) of the Act

2 Rates given in this article are exclusive of surcharge and cess.

3 Section 115UA(2) read with section 112 of the Act

4 Section 10(23FC)(a) of the Act

5 Section 194LBA(1) and section 194LBA(2) of the Act

6 Section 10(23FC) & 10(34) of the Act

7 Section 115O(7) of the Act

8 Section 115BBDA of the Act

the hands of InvITs. However, the taxability of capital gains may vary, according to the type of investments and the period of holding of such investments. We have captured the taxability[9] under various scenarios in the below table:

Sr. No	Investment	Period of holding	Applicable tax rate
A	Equity shares of SPVs	As per the SEBI regulations, it is mandatory to hold investment in SPV at least for three years. Since the investment in equity shares of SPV would be held for more than 24 months, it would always be long term capital asset. Therefore, the gains arising on transfer of such equity shares would always be long term capital gains	If shares of SPV are listed on recognised stock exchanges in India, then the gains are taxable at 10 per cent without any indexation benefit. Otherwise, the gains would be taxable at 20 per cent with indexation benefit In case these listed shares are held by InvITs prior to 31st January, 2018, then cost step-up with respect to the market value as on 31st January, 2018 is available.
B	Equity shares of listed companies	Long-term capital asset: holding period over 12 months prior to the date of transfer	Long-term capital gains would be taxable at 10 per cent without indexation benefit. In case these listed shares are held by InvITs prior to 31st January, 2018, then cost step-up with respect to the market value as on 31st January, 2018 is available
		Short-term capital asset: holding period up to 12 months prior to the date of transfer	Short-term capital gains would be taxable at 15 per cent
C	Any other asset	Long-term capital asset: holding period over 36 months prior to the date of transfer	Long-term capital gains would be taxable at 20 per cent with indexation benefit
		Short-term capital asset: holding period up to 36 months prior to the date of transfer	Short-term capital gains would be taxable at 30 per cent

Since the capital gains are taxable in the hands of InvITs, it would be exempt in the hands of Unit Holders on distribution.

Any other income:
Any other income of the InvITs shall be taxable at MMR[10].

9 Section 115UA(2), Section 111A, section 112 and section 112A of the Act

10 Section 115UA(2) of the Act

Taxation in the hands of Sponsor/Unit Holders

Sponsor:

As per the SEBI regulations, the Sponsor is required to transfer his holdings (assets, shares and interest) in the SPV to the InvITs before allotment of units to the other investors. The sponsor can also receive units of InvITs in exchange of assets/shares of SPV.

To give parity and not to place the Sponsor in a disadvantageous tax position, the transaction of exchange of shares of SPV with the units of the InvITs falls outside the scope of taxable transfer[11]; hence, no capital gain tax is attracted on exchange of shares of SPVs with the units of InvITs.

The Sponsor is liable to pay capital gains tax when the units of the InvITs are sold. To compute capital gains in the hands of the Sponsor on account of transfer of units of InvITs received on exchange of shares, cost and 'period of holding' of shares of SPV are also to be considered/included[12].

To provide tax deferment/neutrality from Minimum Alternate Tax (MAT), which may arise due to recording of exchange of shares with the units of InvITs at fair value in the books of Sponsor (if Sponsor is a Company), the MAT provisions are modified. So, the notional gain or loss resulting from any such exchange or any change in the carrying amount of the said units is excluded for levy of MAT[13]. At the time of eventual transfer of units, MAT will be payable with reference to profits computed considering the original cost of the shares and not the price of units prevailing in the books.

Further, in a situation where the Sponsor transfers the infrastructure asset to the InvITs, in absence of exemption similar to one provided for transfer of shares of SPV, such transfer is subject to tax in the hands of the Sponsor. Depending upon the holding period of the infrastructure asset it will be categorised as long-term capital asset (more than 36 months) or short-term capital asset (36 months or less). Most likely, InvITs would buy the infrastructure asset on a 'going-concern' basis for a lump sum consideration and, hence, specific provision dealing with slump sale[14] would apply to such transfer. If the gain is long-term in nature, it will attract 20 per cent tax and in case the gain is short-term in nature, it will attract 30 per cent tax.

Unit Holders

The income distributed to the Unit Holders (including Sponsor) is of the same nature and in the same proportion, as it had been received by or accrued to the InvITs[15]. In other words, interest income earned and distributed by InvITs, shall be taxed in the hands of Unit Holders as interest.

Tax implications in the hands of Unit Holders are as follows:

Interest income

Interest or part thereof distributed by the InvITs to the Unit Holders is taxable in the hands of Unit Holders[16]. As discussed above in the taxability of the InvITs, only the interest received from the SPV (set up as company) would be taxable in the hands of Unit Holders.

While non-resident Unit Holders are liable to pay tax at five per cent on such interest income, resident Unit Holders are liable to pay tax as per the normal tax rates.

11 Clause (XVII) to section 47 of the Act

12 Section 2(42A)(hc) and section 49(2AC) of the Act, as amended by Finance Act, 2014

13 Section 115JB of the Act

14 Section 50B of the Act

15 Section 115UA of the Act read with section 10(23FD) of the Act.

16 Section 115UA of the Act read with section 10(23FD) of the Act.

Dividend income

Dividend received from the InvITs is not taxable in the hands of the Unit Holders.

Capital Gains

As per the SEBI regulations the units of the InvITs must be listed on the recognised stock exchange in India. Further, the Unit Holders are liable to pay 'Securities Transaction Tax at the time of transfer of such units.

A unit would be considered as short-term capital asset[17] if held for 36 months or less and gains arising on transfer of such short term assets would be subject to tax at the rate of 15 per cent[18].

In case the units are held for more than 36 months it would be considered as long-term capital asset. Gain arising on transfer of such long term asset, in excess of INR one lakh, would be subject to tax at the rate of 10 per cent[19]. However, in case, no security transaction tax is paid on transfer, the gains will be taxable at 20 per cent with indexation and at 10 per cent without indexation, if held for long term and at applicable rates if held for short term.

For non-resident Unit Holders, the applicable tax treaty would also need to be analysed as some tax treaties provide exemption on capital gains.

No relaxation related to MAT is given to the Unit Holders as given to the Sponsor. Therefore, if the units are recorded at fair value in the books of account and Unit Holder is a company, it could be subject to MAT (if applicable) on such resultant notional gains.

Any other income

Any other income distributed by the InvITs is exempt in the hands of the Unit Holders as the same has already been taxed at MMR in the hands of the InvITs.

17 Section 2(42A) of the Act

18 Section 111A of the Act

19 Section 112A of the Act

20 Section 115-O(7) of the Act

Practical issues/challenges

Whilst the legislators have been very pro-active to the demand of the stakeholders and the Act has been constantly modified/amended to address the concerns raised by the Industry, there are certain tax matters which are yet to be resolved.

We have discussed some of such tax issues in the following paragraph:

Holdco - SPV structure

Dividend income

As per the SEBI regulations, InvITs can hold infrastructure assets either directly, through a single layer SPV, or through Holdco, which holds in SPVs having infrastructure assets.

In the Holdco structure, the dividend declared, distributed or paid by the SPV will travel to Holdco and then from Holdco to InvITs.

As per the provisions of the Act[20], DDT does not apply if the SPV declares/pays dividends to the InvITs. The provisions do not cover the two-level structure and thereby dividend declared/paid by SPV to Holdco could be subject to DDT. This will result into an additional tax cost and will have a significant adverse impact on the investors return as compared to single level SPV structure.

Therefore, the legislators should suitably amend the Act to plug this ambiguity to bring two-level structure at par with the single level structure.

Interest income

Similarly, the interest income earned from SPV is exempt in the hands of InvITs. However, similar exemption to interest income earned by the Holdco from SPV is not given. This will again result in an additional cost and will result in making two-level structure unviable.

Interest received from SPV set up as LLP

As per the provisions of the Act[21], interest income received from SPV set up as a Company is exempt in the hands of InvITs as SPV is defined to include only Company structure.

It is pertinent to note that the SEBI regulations permit the SPV to be formed either as a Company or LLP, whereas the benefit of pass through to interest income under the provisions of the Act is available only in the Company structure. This makes LLP structure tax inefficient.

Therefore, amendment is required to be made in the definition of SPV to include not only SPV set up as Company, but also SPV set up as LLP.

Further, the InvITs typically incur expenses towards management fees, audit fees, trustee fees, valuer fees, other operating fees etc. it is important to evaluate the deductibility of such expenses against the interest income earned by InvITs. There is no specific guidance available as how to divide the expenses between various heads of income or to claim the expenses entirely against the interest income.

Period of holding for units of InvITs

Units of InvITs are required to be held for more than 36 months[22] to be qualified as long-term capital asset. Longer holding period to qualify as long-term capital asset is discouraging for Sponsors/Unit Holders.

In order to bring parity between units and listed equity shares, the legislators should consider reducing the holding period for units of InvITs to 12 months to qualify for long-term capital asset.

Reporting Requirement

The InvIT is required to comply with various reporting requirements under the provisions of the Act. Such reporting requirements are discussed below:

Intimation to the unit holders

To facilitate the unit holders to determine the appropriate tax liability, InvITs are required to furnish 'statement of income distributed to its Unit Holders'[23] in form 64B by 30th June of each year.

Intimation to the tax authorities

The InvIT is required to furnish a duly verified Form 64A 'statement of income distributed'[24] to the tax authorities electronically under digital signature by 30th November of each year. The Form needs to be verified by an Accountant[25].

Return of Income

The InvIT will be required to furnish its return of income on or before 30th September of the assessment year succeeding the relevant previous year[26].

Remittance to non-resident unit holders

The InvITs is required to furnish Forms 15CA and 15CB[27] with the authorised dealer for remitting funds outside India i.e. where the income is distributed to non-resident Unit Holders.

Transfer pricing compliance

In case of international transactions with associated enterprises, InvIT is also required to evaluate the applicability of the transfer pricing provisions and accordingly ensure the

21 Section 10(23FC) of the Act

22 Section 2(42A) of the Act

23 Rule 12CA of the Income Tax Rules, 1962

24 Rule 12CA of the Income Tax Rules, 1962

25 As defined in Explanation to Section 288(2) of the Act

26 Section 139(1) of the Act

27 Section 195 read with Rule 37BB of the Income tax Rules, 1962

electronical filing of the Chartered Accountant's report in the prescribed Form 3CEB by the 30th November of the relevant assessment year.

Withholding tax compliance

The InvIT is require to withhold tax at source, while making interest payment to unit holders. The InvIT would need to consider whether the tax need to be deducted on (i) gross income (ii) income net of all expenses of the InvITs (iii) income net of tax deductible expenses incurred at invITs level. Further, it will be subject to the normal tax deduction at source requirement with respect to other payments made by it. Additionally, it also required to file quarterly statement of deduction of such taxes, under form 26Q and 27Q on or before the below due dates:

- For 1st April to 30th June – 31st July
- For 1st July to 30th September – 31st October
- For 1st October to 31st December – 31st January
- For 1st January to 31st March – 31st May

FATCA

The InvIT is required to identify its non-resident Unit Holders and comply with the FATCA reporting requirements in the prescribed form by the 31st May of the relevant assessment year.

Our comments

As the Indian economy paving its way of becoming the fasted growing economy in the world, the infrastructure sector will become the key driver in the coming years. The InvITs regulations are evolving and the SEBI is proactively seeking stakeholders' feedback to improve the attractiveness of this investment vehicle. Special tax regime introduced for InvIT is lucrative and attractive from investor perspective, but to harness the full potential of InvIT, the Indian Government should consider making appropriate amendments to the Act to eliminate the above mentioned practical challenges.

❍❑❍

Duty is seldom sweet. It is only when love greases its wheels that it runs smoothly; it is a continuous friction otherewise. How else could parents do their duties to their children, husbands to their wives, and vice versa? Do we not meet with cases of friction every day in our lives? Duty is sweet only through love, and love shines in freedom alone.

— Swami Vivekananda

CA Kishore Purohit

Infrastructure Investment Trusts Indirect Tax – Key Provisions

Founded on the notion of 'One Nation – One Market - One Tax', the country's biggest reform in the history of Indian taxation structure took place on 1st July 2017. Claimed as the 'Game Changer' and biggest economic reform since independence, the Goods and Services Tax ('GST') completed one year of its implementation.

The roll-out of GST was more of "Kabhi Kushi – Khabhi Gum" type feeling as the implementation of new regime was accompanied with frequent changes in rules and procedures, some being hailed and some strongly opposed by the business community. Though initial few months of the implementation were full of confusion relating to compliance, availability of Input credit and refunds, over the period the industry has learned through experience and have embraced the new regime with both hands. The implementation of GST tax reform has provided the necessary elixir to the Indian economy and huge shift have been seen from unorganized to organized sector.

Government is relying heavily on GST to achieve multiple economic objectives in one stroke – promoting the manufacturing sector, boosting exports by making production more competitive, creating more jobs, improving the investment climate, cutting down tax evasion and lowering the compliance cost to businesses. Other key sector which government is eyeing to have some positive momentum due to GST is the Infrastructure Sector which has seen a drastic slow down, sluggish demand and been grappling with many regulatory changes and liquidity crunch.

The infrastructure sector is the backbone of the Indian economy and every government has been making efforts to boost the sector through various schemes and incentives. The sector is highly responsible for propelling India's overall development and enjoys intense focus from Government for initiating policies that would ensure time-bound creation of world class infrastructure in the country. Infrastructure sector includes power, bridges, dams, roads and urban infrastructure development.

India has a requirement of investment worth Rs 50 trillion (US$ 777.73 billion) in infrastructure by 2022 to have sustainable development in the country. India is witnessing significant interest from international investors in the infrastructure space. The magnitude at which the infrastructure development is being undertaken in India, the burden to support such heavy expenditure long gestation projects falls on the banking sector. Securing funding for infrastructure projects has forever been a challenge in India. This has been particularly acutely felt in recent times with bad loans impacting all major banks who have then gone on to either roll back their targets for disbursement and restrict exposure to the infrastructure sector, thus making it more difficult to get loans, or increased interest rates on existing loans. Also, the opportunity to get funds from outside India has dried up as the investors not finding a suitable avenue to invest in the sector. This doesn't show positive sign for the companies that work in this sector or even for the scale of infrastructure transformation put forth by the Indian government.

Many times it become difficult for the developer to balance capital needs for under-construction and completed projects, which could end up impacting the growth potential. To have a secondary source of funding, the Government of India along with Securities and Exchange Board of India ('SEBI') introduced Infrastructure Investment Trusts ('InvITs') in India in 2014. The objective of InvITs is to facilitate investment in the infrastructure sectors and also help in attracting international finance.

This securitization vehicle finances/ refinances infrastructure projects in the country, thereby propelling India's overall development. Also, it helps reduce burden on banks, which is the primary source to fund such projects, especially in this time of infrastructure boom in the country. By leveraging said structure, the developer can transfer the fully operational, cash making, projects into an InvIT as a separate vehicle, which then gets listed as an independent trust, having its own fixed revenues and costs. InvITs aid in freeing up current developers' capital for reinvestment into new infrastructure projects since there are many infrastructure companies whose funds are locked up in completed/ substantially completed infrastructure projects which can otherwise be used for furthering infrastructure development in the country.

InvITs are instruments which operate like Mutual Funds. They operate on the model of pooling the funds from a number of investors to invest in assets that give cashflow over a period of time. Part of this cashflow is distributed as dividend to the investors. Since InvITs are highly regulated, it helps attracting international finance into Indian infrastructure sector. By subscribing to the units of InvITs, the investors are able to hold a diversified portfolio of infrastructure assets and also participate in the decision-making process of the InvITs. The Government is encouraging setting up of such infrastructure vehicle by awarding income tax benefits and thereby fastening the country's development.

Structure of InvIT

Before we move forward in discussing the Indirect tax implications on the activities carried out by InvIT, it is important to understand its structure. InvITs are set up as a trust and registered with SEBI. An InvIT has 4 parties such as Trustee, Sponsor(s), Investment Manager and Project Manager.

The trustee, who oversees the role of an InvIT is a SEBI registered debenture trustee and he cannot be a related party or an associate of the Sponsor or Manager.

"Sponsor" means promoters and refers to any company or Limited Liability Partnership (LLP) or body corporate with a networth of Rs. 100 crore which sets up the InvIT and is designated as such at the time of application made to the SEBI and in case of PPP projects, it refers to the infrastructure developer or a special purpose vehicle (with the networth as specified in the PPP contract) holding concession agreement;

Promoters or Sponsor(s), collectively, have to hold atleast 25% in the InvIT for atleast 3 years, except for the cases where a regulatory requirement/ concession agreement requires the sponsor to hold a certain minimum percent in the underlying SPV. In such cases the consolidated value of such sponsor holding in the underlying SPV and in the InvIT cannot be less than 25% of the value of units of InvIT on post-issue basis.

Investment Manager is a company or Limited Liability Partnership (LLP) or body corporate which manages assets and investments of the InvIT and undertakes activities of the InvIT.

Project manager means the person designated as the project manager by the InvIT, responsible for achieving execution of the project and in case of PPP projects, it refers to the entity responsible for such execution and achievement of project milestones in accordance with the concession agreement or any other relevant project document.

If the investment is done through an SPV, then InvIT has to hold a controlling interest with not less than 50% of the equity share capital or interest in SPV, except where the same is not possible because of a regulatory requirement/ requirement emanating from the concession agreement. In such cases sponsor has to enter into an agreement with the InvIT, to ensure that no decision taken by the sponsor, including voting decisions with respect to the SPV, are against the interest of the InvIT/ its unit holders.

Indirect tax implications on the Trust (InvIT)

GST is payable only when a taxable supply of goods and / or service is made for a consideration. The term supply is the cornerstone of the GST Law.

As explained above, InvITs are instrument to pool small sums of money from a number of investors to invest in assets. Hence, the major income earned out of such pooling activity by InvIT is dividend, Interest income and capital gain made on disposal of asset in hand or sale of controlling rights / shares held in SPV.

In order to analyze the GST implications on the above stated income streams earned by InvIT, it would be relevant to refer the definition of 'Goods' and 'Services' as provided under the GST legislation.

Section 2(52) of the Central Goods and Services Tax Act, 2017 ('CGST') define 'Goods' as under:

""goods" means every kind of movable property ***<u>other than money and securities</u>*** *but includes actionable claim, growing crops, grass and things attached to or forming part of the land which are agreed to be severed before supply or under a contract of supply"*

Further, Section 2(102) of the CGST Act define the term 'Services' as under

""services" means anything ***<u>other than goods, money and securities</u>*** *but includes activities relating to the use of money or its conversion by cash or by any other mode, from one form, currency or denomination, to another form, currency or denomination for which a separate consideration is charged".*

From the above definition it is clear that 'Securities' are neither classified as goods nor services and hence are outside the gamut of GST. Hence, any income earned from such securities held (such as dividend, profit from sale of securities etc.) would not be subject to GST in the hands of InvIT.

Further, in many occasion, InvIT invest the surplus funds in fixed deposits with Banks or Financial Institutions and earns Interest income out of such investments / loan extended. In connection to such Interest income earned, it is important to note that Notification No. 12/2017 – Central Tax (Rate) dated 28th June 2017 provides exemption to interest income earned out of loan, deposit or advance provided. Hence, there will be no GST implications in the hands of InvIT on earning interest income. In case if InvIT is earning rental income from the projects held by it, the same would be subject to GST @ 18%. Sale of under-constructed property is also subject to GST having an effective rate of 12% (after claiming deduction of 1/3rd contract value assigned towards value of land).

Though InvIT does not have major GST implications on its income earned, there is tax cost associated with the various services that are availed by InvIT for carrying out its operations. Management Services rendered by a service provider / Fund Manager to InvITs is subject to GST @ 18% which is not creditable / available as set-off to InvIT in light of the fact that there is no taxable income earned by InvIT which is subject to GST. Hence, GST charged by Fund Manager and other service providers becomes a cost which would lead to have an impact on investors profitability / earnings.

Considering the tax cost of 18% impacting the investor's profitability, one may argue that an InvIT is in essence pools contributions made by the investors and therefore should not be viewed as distinct entity separate from its investors. In fact, recognizing the 'pooling' concept, income tax law has accorded 'pass-through status' to AIFs, / InvITs and their income is taxed as if investors had made the investments directly. Under indirect taxation, however, making fund manager services and the services provided by others to Indian AIFs / InvITs liable to GST, contradict this pass-through status.

Indirect tax implications on the Investors (which include Sponsors and other investors)

Normally, the Sponsor transfer his holdings (assets, shares and interest) in the SPV to InvIT in lieu of fresh units being issued by the latter. Further, the Investor / Sponsor of InvIT would earn dividend, Interest Income and Capital gain from sale of its units (issued by InvIT).

As discussed above, any income earned from transfer of securities is outside the gamut of GST as the same is neither covered under the definition of 'Goods' nor 'Services'. Hence, any income earned from transfer of holdings, sale of units issued by InvIT would not be subject to GST. Further, dividend income is not towards supply of any service and is rather a share of profit which is transaction purely in money terms thereby not having any GST implications.

Further, as stated above, specific exemption has been provided for non-levy of GST on interest income earned thereby keeping it out of GST tax net.

Though there is no direct impact of GST on the income earned by the Investor / Sponsor as almost all income earned from InvIT is immune from GST, the Investor / Sponsor would be require to bear the GST cost as they need to reverse certain portion of its input credit.

Section 17(2) of the CGST Act specifically provides that where input services or goods procured are used by the registered person in effecting taxable as well as exempt supplies, the credit would be admissible and restricted only to the extent it is attributable towards the taxable supply. Hence, any input credit (of goods and / or services) attributable towards exempt supply needs to be reverse / written off to profit and loss account.

The term 'Exempt Supply' has been defined under Section 2(47) of the CGST Act which reads as under:

" "exempt supply" means supply of any goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax under section 11, or under section 6 of the Integrated Goods and Services Tax Act, and includes non-taxable supply"

It is important to note that exempt supply covers only those supply which either attract nil rate of duty or wholly exempt from tax by virtue of exemption notification being issued exempting the same and also includes non-taxable supply (i.e. supply not subject to tax).

Interest earned by Investors / Sponsors would get covered under the exempt supply as the same as been exempted by virtue of exemption notification being issued. Further, though Securities are neither 'Goods' nor 'Services', Section 17(3) of the CGST Act specifically provides that transaction in securities would be construed as exempt supply.

Investor / Sponsors, apart from earning income from InvIT, would be having other business also wherein they would be using various input services and goods and discharging GST. Considering the fact that the Investors / Sponsors would be having 2 separate set of income – one taxable and other exempt, they would be require to reverse certain potion of input credit attributable to exempt income.

Rule 42 of the Central Goods and Services Rules, 2017 ('CGST Rules') provides a detail mechanism for working out the input credit which is attributable towards exempt supply and which needs to be reversed on a monthly basis. Further, under Rule 43 of CGST Rules it has been provided that though Interest income, earned by Investors / Sponsors, has been exempted from levy of GST by virtue of exemption notification, no reversal of input credit is required for such income earned (as for the purpose of such reversal the same is not to be considered in the aggregate valuation for working out the reversal).

With respect to income earned from Securities (i.e. from sale of units / holdings), Explanation to Rule 45 of CGST Rules provides that 1% of the sale value of such transfer / transaction involving such securities (units / holdings / shares) should be considered as exempt turnover / value. Interestingly, what is considered as exempt is 1% of the sale value and not any profit element – that means that even if the transaction of transfer of shares / units leads to loss, the Investor / Sponsor would be required to consider 1% of such sale value as exempt and reverse input credit attributable to such exempt supply.

By virtue of the said provision, Investors / Sponsors would be forced to reverse input credit attributable to such exempt supply (i.e. transaction in securities), thereby adding the same to their overall tax cost and which will be impacting their overall profitability. This would clearly lead to leakage of credit for Investors / Sponsors and may force them to rethink and work out whether investing via InvIT is a viable / profitable option.

Other GST related issues being faced by InvIT and Investor / Sponsors is handling complex compliances and increase in compliance cost. Other point for reconsideration for the government is to allow credit of GST paid on goods and services used for construction purposes if such constructed property is considered as business asset and the income in the form of rentals is generated out of such asset which is subject to GST. The Infrastructure industry await adequate clarification with respect to tax implications in the hands of land owner in connection with transfer of development rights pursuant to Joint Development Agreements entered with developer.

Government understand the importance and the potential of Infrastructure sector towards the growth of the economy and have been making all attempt to provide maximum incentives / benefits to the said sector so that they get assured long term investment. One such move by government was to reduce the GST rate from 18% to 12% on supply of Renewable Energy Certificate thereby providing much needed boost to renewable energy sector.

Government's major focus is to revive the housing demand, including affordable housing. This is a huge opportunity, with a multiplier effect on the demand for related products, as well as job creation. However,

issues like land acquisition, delay in licensing and project implementation, tax policy uncertainty, corruption are quite common problems which leads to negative perception about the country's ability to offer predictable policy environment and consistent long term returns with low risk.

To conclude, the infrastructure sector over the years have transformed itself from Government funded projects to new business structures which include partnering with private sector with the latter having partial or complete ownership. Setting up of Real Estate Investment Trusts (REITs) / InvITs have been really helpful to fund the capital-starved developers. Though currently, the sector is being hit by slowdown in the economy and strain being faced by various infrastructure developers, it is poised to bounce back with new opportunities in future. No doubt there have been path breaking reform initiatives from government's end, but the immediate challenge before it is to ensure smooth and effective implementation of these measures while executing its unfinished agenda of reforms and solving some key challenges related to reducing regulatory uncertainty, developing appropriate financing mechanisms and ensuring efficient project management. Considering the fact that government is moving ahead on "Housing for all by 2022" mission very seriously, it needs to rebuild the confidence in the private sector thereby leading to more proactive participation from private sector in the form of Public-Private Partnership (PPP) projects.

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SS-X-104

CA Jayesh Gandhi

Accounting Aspects of REITs and InvITs

1. Preamble

1.1 There is always a need for investing funds in the instruments which give better returns. Investors all over the world explore different avenues for investment. To facilitate and regulate conduct of such intermediate entities, The Securities & Exchange Board of India (SEBI or The Board) had issued Venture Capital Funds Regulation in 1996. The venture capital industry was growing at a rapid speed and there was a dramatic change in the environment in which venture capital world operated. To address the changes in 2012 SEBI came out with Alternative Investment Funds (AIF) Regulations in substitute of VCF Regulations.

1.2 As the venture capital industry became more diverse and sophisticated, it was observed that VCFs / AIFs which invest in real estate or such property assets have problems with the liquidity and are not able to sell their units to other investors in a seamless manner. This was also one of the reasons that many HNI were not attracted towards AIFs investing in real estate or illiquid properties. There was a need to have separate regulations for such funds and making it mandatory for their units to be listed on the recognised stock exchanges. SEBI issued a new set of regulations – Securities & Exchange Board of India (Real Estate Investment Trusts) Regulations, 2014 and Securities & Exchange Board of India (Infrastructure Investment Trusts) Regulations, 2014.

2. What is REITs and InvITs

2.1 REIT is trust registered under REITs Regulation whose units are listed on recognised stock exchange and which invests in Special Purpose Vehicles (SPV), Holding companies (Holdco), related securities or real estate properties. The Holdco is a company that invests in one or more SPVs and the SPV in turn invests in real estate projects.

2.2 InvIT is trust registered under the InvITs Regulation, whose units are listed on recognised stock exchanges, and which invests in SPVs, Holdcos, related securities or infrastructure projects. The Holdco is a company that invests in one or more SPVs and the SPV in turn invests in infrastructure projects.

3. Accounting Framework

3.1 Both (REITS & InvITs) regulations do not provide any accounting framework as such. The same is true even for VCF and AIF Regulations. At present, such entities are following Generally Accepted Accounting Principles (GAAP) in India and were following Accounting Standards issued by The Institute of Chartered Accountants of India (ICAI), to the extent applicable. It is important to note that Accounting Standard-13, in respect of accounting of investments is not applicable to VCF resulting into non-applicability of any standard to major part of their assets.

3.2 In my view, for REITS & InvITS, Ind AS is applicable after considering following factors:

Clause 13(2) of the Regulation deals with responsibilities of auditors which provides that the auditor shall conduct audit of the accounts and draft the audit report based on the accounts examined by him and after taking into account the relevant accounting and auditing standards, as may be specified by the Board. Further, a circular dated October 20, 2016 and December 26, 2016 of SEBI relating to disclosures of financial information to be made in offer documents of InvITs and REITs respectively provides that the financial information shall be prepared in accordance with the Indian Accounting Standards (Ind AS) and / or any addendum thereto as defined in Rule 2(1) (a) of the Companies (Indian Accounting Standards) Rules, 2015.

From the above provisions it can be concluded that the financial statements of REITS and InvITS entities shall be prepared in compliance with Ind AS.

3.3 The SEBI Regulations do not provide format of the financial statements for REIT / InvIT. However, the circular for offer document, issued under the Regulations, have given the format of the financial statements of REITs / InvITs. As Schedule III of the Companies Act does not apply to entities other than companies, it is not necessary for REIT / InvIT to follow the format given in the said schedule. The format/ minimum line item for financial statements have been given below:

Balance Sheet

I. Assets

a) Property, plant and equipment

b) Capital work-in-progress

c) Investment property

d) Intangible assets

e) Inventories

f) Other receivables

g) Other financial assets (excluding Inventories & Other Receivables)

h) Cash and cash equivalents

i) Deferred tax assets

j) Assets for current tax

II. Equity and Liabilities

a) Unit capital

b) Other payables

c) Provisions

d) Financial liabilities (excluding amounts shown under (b) and (c)), separately disclosing liabilities owed to sponsors

e) Liabilities for current tax

f) Deferred tax liabilities

g) Other liabilities

Statement of Profit & Loss

I. Incomes and gains

a) Revenue from operations

b) Dividend

c) Interest

d) Profit on sale of assets/investments

e) Other income *(Clearly indicate nature of such income)*

II. Expenses and losses

a) Valuation expenses

b) Audit fees

c) Insurance & Security expenses

d) Employee Benefits Expenses

e) Project management fees (including fees paid to project manager) ***(this item is only in case of InvIT)***

f) Investment management fees (including fees paid to manager)

g) Trustee Fee

h) Depreciation on property, plant and equipment

i) Amortisation of intangible assets

j) Finance Cost (Interest)

k) Custodian fees

l) Registration fees

m) Repairs and maintenance in case of real estate assets

n) Loss on sale of assets/investments

o) Other expenses (clearly indicate nature of such expense)

III. Profit or loss for the period before income tax

IV. Tax expense (current tax and deferred tax)

V. Profit or loss for the period after income tax

VI. Items of other comprehensive income

VII. Additional line items (if applicable)

a) Items that will not be reclassified to profit or loss

b) Income tax relating to items that will not be reclassified to profit or loss

c) Items that will be reclassified to profit or loss

d) Income tax relating to items that will be reclassified to profit or loss

VIII. Total comprehensive income for the period (V+VI) (Comprising profit (loss) and Other comprehensive income for the period)

Statement of Changes in Equity

I. Total comprehensive income for the period

II. For each component of unit holders' equity, a reconciliation between the carrying amount at the beginning and the end of the period, separately (as a minimum) disclosing changes resulting from:

a) Profit or loss

b) Other comprehensive income

c) Aggregate amount of investments by unit holders in REIT / InvIT, and dividends / other distributions by REIT / InvIT to unit holders

Cash Flow Statement

Needs to be prepared in accordance with Ind AS 7 Statement of Cash Flows and the format given in the said standard shall be used.

For all the above, comparative period figures shall be provided for better analysis of the financial statements.

3.4 Disclosure of key financial statements in the offer documents require the entities to provide Statement of Net Assets at Fair Value in the following format:

Particulars	Book Value	Fair Value
Assets (A)	xxxx	xxxx
Liabilities (B)	xxxx	xxxx
Net Assets (A – B) = C	xxxx	xxxx
No. of Units (D)	xxxx	xxxx
NAV (C/D)	xxxx	xxxx

As this information is relevant for unit holders, it is recommended to form part of the financial statements.

3.5 Current and Non-current bifurcation

As the format does not provide such bifurcation, it is not necessary to bifurcate assets and liabilities into current and non-current items, which is relevant in case of companies. As the REIT / InvITs entities are not likely to have its own operating cycle, it gives support to the view that bifurcation of current and non-current is not required.

3.6 Consolidation of financial statements of Holdco / SPV with REIT / InvIT

A question comes to the mind that since REITs / InvITs require to hold 51% or more of the Equity Share Capital issued by the Holdco or SPV and thus has a controlling interest on the SPV / Holdco, whether the financial statements of the Holdco / SPV should be consolidated with the REIT / InvIT. Generally, the Holdco / SPV are companies incorporated under the Companies Act, 2013 while the REITs / InvITs are Trusts. For the better understanding of the performance and the position of Assets / Liabilities as at the balance sheet date, it is better to provide consolidated financial statements. It is important to note provisions of Ind AS 110 in this regard, which is as follows:

"4 (c) an investment entity need not present consolidated financial statements if it is required, in accordance with paragraph 31 of this Ind AS, to measure all of its subsidiaries at fair value through profit or loss "

"27 A parent shall determine whether it is an investment entity. An investment entity is an entity that:

(a) obtains funds from one or more investors for the purpose of providing those investor(s) with investment management services;

(b) commits to its investor(s) that its business purpose is to invest funds solely for returns from capital appreciation, investment income, or both; and

(c) measures and evaluates the performance of substantially all of its investments on a fair value basis."

"31 Except as described in paragraph 32, an investment entity shall not consolidate its subsidiaries or apply Ind AS 103 when it obtains control of another entity. Instead, an investment entity shall measure an investment in a subsidiary at fair value through profit or loss in accordance with Ind AS 109."

"32 Notwithstanding the requirement in paragraph 31, if an investment entity has a subsidiary that provides services that relate to the investment entity's investment activities (see paragraphs B85C–B85E), it shall consolidate that subsidiary in accordance with paragraphs 19–26 of this Ind AS and apply the requirements of Ind AS 103 to the acquisition of any such subsidiary."

From the reading of above provision in Ind AS 110, it appears that there is no need of consolidation of Holdco / SPV into the REITs / InvITs, as subsidiary of REITs / InvITs are not likely to provide services contemplated in para 32 of Ind AS 110.

It should, however, be noted that as per the circulars dated 20th October 2016 and 26th December, 2016 issued by SEBI on InvITs and REITs respectively, the SPVs and Holdcos should be consolidated with the REITs / InvITs. The provisions of these circulars issued under SEBI Regulations will override the provisions of Ind AS 110. As provided in the said circulars, for consolidation purpose Ind AS 110 principles shall be applied.

4 Accounting treatment of investment / assets and liabilities in the standalone financial statements

4.1 As provided in the regulation, the investment by REITs / InVITs shall be in the form of 51% or more investment in Holdco / SPVs or directly into securities or projects of real estate or infrastructure entities. The investments are generally made in the form of direct equity, preference shares or various types of debentures / bonds. In the subsequent paragraphs, we will deal with various type of investments / assets.

4.2 If the investments are made directly into projects, accounting will be based on the Ind AS applicable to such activities. For revenue recognition, Ind AS 115 will be applicable. Similarly for project inventory, Ind AS 2 will be applied.

4.3 In case of financial liabilities by way of borrowings, entities should apply provisions of Ind AS 109 and accordingly borrowings can be accounted on the basis of amortised cost. It is not advisable to select accounting of borrowings at fair value through profit or loss (FVTPL) as such borrowings are generally not traded. Consequently, initial borrowing cost incurred is considered in working out effective interest rate (EIR) together with cash outflow for interest, premium at the time of maturity and principal repayment. The charge of borrowing cost to the statement of profit and loss shall be based on EIR.

4.4 Investments made by REITs / InvITs in the equity shares, preference shares or debentures shall be treated as 'financials assets' as provided under Ind AS 109. Following provisions of Ind AS shall be relevant for accounting of financial assets:

As per Ind AS 109, an entity shall classify financial assets (other than investment in subsidiaries / joint ventures / associates) as subsequently measured at:

(a) Amortised cost, or

(b) fair value through other comprehensive income (FVOCI) or

(c) fair value through profit or loss.

As per Ind AS 27, measurement of investments in subsidiaries / joint ventures / associates can either be at cost or in accordance with Ind AS 109.

Ind AS 109 – "4.1.2 - A financial asset shall be measured at amortised cost if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is to hold financial assets in order to collect contractual cash flows and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding."

Ind AS 109 – "4.1.2A - A financial asset shall be measured at fair value through other comprehensive income if both of the following conditions are met:

(a) the financial asset is held within a business model whose objective is achieved by both collecting contractual cash flows and selling financial assets and

(b) the contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding."

Ind AS 109 – "4.1.4 - A financial asset shall be measured at fair value through profit or loss unless it is measured at amortised cost in accordance with paragraph 4.1.2 or at fair value through other comprehensive income in accordance with paragraph 4.1.2A."

An entity, however, may make an irrevocable election for particular investments in equity instruments (other than those held for trading) to present subsequent changes in fair value in other comprehensive income. In such cases, profit or loss on sale shall also be taken to other comprehensive income.

4.5 Equity instruments – Based upon a combined reading of the Ind AS 109, it is clear that the investment by REITs / InvITs in Equity instruments of SPV or Holdco should preferably be measured at FVTPL so as all the assets are at fair value and it is easier to compute NAV of the REIT / InvIT. There is, however, an option to carry investments in subsidiaries / joint ventures / associates at either cost or FVOCI and other equity investments at FVOCI.

4.6 OCDs, NCDs, ZCBs and Redeemable preference shares – These financial assets are debt instruments. These instruments typically have fixed cash flows of principal and interest on specified dates and hence passes the solely payments of principal and interest (SPPI) test. In certain cases debentures carry an option of conversion into equity shares which can be exercised only on the occurrence of any default or event or lapse. As the option is in the nature of protective rights, such instruments can be treated as debt instruments. Generally such debt instruments are invested for holding till maturity and not for trading and hence it is preferable to account it at amortised cost. There is, however, an option to carry such investments as FVTPL / FVOCI.

4.7 Impairment of Financial Assets – All investments which are not carried at fair value should be tested for impairment and the impairment loss should be recognised in P&L / OCI as the case may be.

4.8 Applicability of Expected Credit Loss (ECL)

Ind AS 109 requires provision to be made based on expected credit loss model for any loans and advances or debt instruments. Provisions need to be made based on stage 1, 2 or 3 of the instrument. It also provides accounting of interest income for various stages.

Stage 1 – there is no deterioration / default after initial recognition. Provision needs to be made on the basis of probability of default (PD) for 12 months considering loss given default (LGD).

Stage 2 – there is an increase in credit risk since initial recognition. Provision needs to be made on the basis of life-time PD considering LGD.

Stage 3 – there is credit impairment. Provision needs to be made on the basis of life-time PD considering LGD.

In case of Stage 1 & 2, EIR is calculated based on the gross carrying amount while in case of Stage 3, EIR is calculated based on net carrying amount i.e., net of provisions.

4.9 Other assets and liabilities, which are not likely to be significant, are measured at their respective transaction cost as they are likely to get settled within one year.

5 To conclude

REITs / InvITs entities need to follow Ind AS for accounting, irrespective of size of the fund. There is a flexibility on the format for preparation of financial statements. The disclosures shall be made based on the requirement of Ind AS and specific requirements by the regulations. More clarity is required from SEBI in respect of applicability of consolidation of financial statements, particularly when equity shares are measured at FVTPL. It is expected that over the years accounting will be streamlined, considering requirement of investors.

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> Each man is perfect by his nature; prophets have manifested this perfection, but it is potential in us.
>
> — *Swami Vivekananda*

Siddharth Shah, *Advocate*

Business Trusts – Legal Aspects

Introduction

It is almost a natural phenomenon that every stage of evolution brings with it inherent complexities and a constant need to adapt to such changed environment. And that as a more endowed human species, we all know the extent of change such evolution has brought about in us over the centuries of evolution. The investing world is not different and its different in that the same process of evolution gets crunched into a highly condensed form to respond to the rapidly changing investment environment, macroeconomic shifts in the global economy and a constantly evolving and demanding risk appetite of the investors. And this has constantly pushed the manufacturer of financial products as well as professional advisors to constantly look for innovations in terms of transactions structures, investment products and choice of vehicles to be able to cater to satiate this need of their clients. And this does not mean innovation in terms of just creating products, structures, or vehicles, but also innovating the use and applicability of existing structure or vehicles. And it is this aspect of innovation that we intend to focus on in the context of a vehicle of choice that has emerged in India – the trust!

While we have all been witnessing the increasing use of trust in India in the modern world – a private trust, a mutual fund trust, an AIF trust, a securitisation trust, an employee welfare trust and almost many such other forms, there appears at times a fundamental lack of awareness around the basic concept of a trust. Even more so when there are increasing number of international investors who are made to participate in these vehicles, some of the very basic yet very important questions that may be asked or are at time not fully comprehended are 'What is the nature of a trust?', 'Is trust a legal entity?', 'Does the trust resemble a 'company' or a 'body corporate' and if not, how is it different?', 'Are there different types of trusts?' 'What are the rights of various constituents of a trust?' and so on and so forth.

While in this edition of the journal under various chapters dealing with AIFs, REITs, INVITs, Securitisation one would have invariably seen the use of trust, this article intends to take the readers to in a small way demystify the trust from a legal perspective and elucidate some notions around the use of 'trust' vehicle as more increasingly being referred to as 'business trust' under the tax laws.

History of Trusts

Origin of trusts in India dates back to several centuries. It is a common place transaction where a person would transfer the ownership over a property to another person legally but with a specific mandate to use the trust property in a certain manner for a benefit of certain other person/class of persons with certain specific instructions on its use. Legally it was an absolute transfer of right, title, and interest in property with the transferee but, the transferee was not entirely free to use this property for his own gain and was subjected to certain conditions in relation to the use of the property but someone else. E.g., a person on his deathbed would hand over or transfer his property to someone with clear instruction to hold this for the benefit of his family members or any other person. This created a different and a slightly complex nature of a threeway relationship between the original owner of the property, the person to whom the property was handed over and those who were to benefit out of such property. And it was to define this nature of relationship, it was felt that the conventional laws of contract or transfer of property were not self-sufficient and hence a need to evolve a specific law which not only defines this relationship but also legalises this arrangement. And that was what lead to formulation of trust law.

Trusts in India are governed by the Indian Trust Act, 1882. As one would know, none of the uses of trust as an investment vehicle could never have been imagined and what was it used for was really for private use – e.g., private wealth trust for passing down of assets to generation or for charitable purposes where the property was meant to be handed over to a person to be utilised for public cause/good. But one of the first use of trust as a vehicle as an investment vehicle in India can be said to be the launch of mutual funds in their previous avatar i.e., the erstwhile Unit Trust of India in 1963 and ever since the use and scalability of this vehicle hasn't looked back. And yet, I believe that its potential is not yet fully realised.

This is a classic example of a law which was drafted nearly 150 years back when many of the current uses of a trust could have never ever been imagined, but the law has been so beautifully conceptualised that it has not only survived with minimal amendments but has lent so beautifully to the use of trust for various complex and creative structures that we witness today in the investing world. In a way, this could be a case study for the law makers and drafter of today as to the importance of conceptualisation and drafting to increase the longevity, relevance, and applicability of any law.

Legal nature of a trust

First question or at times a myth that needs to be corrected is that unlike many other forms of entities such as a company, LLP or a body corporate, trust is not a legal entity *per se*. Contrary to the general perception or at times an artificial fiction created for a purpose such as taxation, trust is merely a relationship between its various stakeholders viz., the settlor/author, the trustee, and a beneficiary. And this nature of the trust and its recognition under the trust law is the real hallmark of how creatively a trust has been used and applied to almost innumerable situations including to the modern day investing world. The legal implication of this construct is that generally a trust is not legally entitled to act as a 'person' under law and it is really the trustee who becomes the legal owner of the trust property and can act under the relationship of trust in accordance with the provisions of a trust deed and the statutory powers vested in him under the law for the benefit of the trust and fulfilment of its objectives. Applying this to the real-life situation of vehicles which are used as 'investment trusts' or 'business trusts', any property owned by such trust is only be owned by the trustee as the legal owner and not by the trust. However, some of the laws have evolved to recognise the trust as a rightful owner distinct from the trustee and one such example is the Companies Act, 2013 which replaced the Companies Act, 1956 has amended the provisions of the erstwhile Companies Act, 1956 which restricted a company from registering a 'trust' as a shareholders and thus, subject to the articles of the Company enabling this, a Company is now allowed to register a trust as its member.

Need for Tax Transparency of Investment Vehicles

From a taxation perspective, many developed jurisdictions around the world offered either a choice of vehicle which is tax transparent or offered a choice for a vehicle to be treated as tax transparent for tax purposes. E.g., many common fund jurisdictions like US, Cayman, Luxembourg, etc., allow the use of partnerships wherein the partnership is not taxed and only the partners are taxed such as limited partnerships or LPs. Alternatively, US especially allows even a corporate vehicle to elect itself to be treated as a partnership for tax purpose effectively giving it a tax pass-through. However, in India tax laws had virtually no transparent vehicles and an absence of that would lead to the risk of double taxation of an income both in the hands of the entity as well as the shareholders. Even in partnerships, the entity was treated as a taxable entity even though the partners are not taxed. But obviously till the recent introduction of an LLP in 2012, the general partnership law did not allow for more than 20 partners and that could become a challenge in an investing vehicle at times. Secondly, because the income was attributed to the partnership which was effectively treated as an independent taxable entity, and hence partners are not allowed to take the credit for any gains or losses generated in the partnership. Thus, a need was felt to identify a vehicle which is effectively a non-entity for tax purpose which lead to the discovery of use of trust as an investment vehicle.

Keeping aside the specific sections creating a tax-pass through for certain types of investing vehicles in the resent times, under the general provisions relating to taxation of a trust, it has been clearly established that (i) a trust is not a separate taxable entity in general (ii) either a trustee or the beneficiary can be taxed on the income of the trust but not both thereby ensuring a single level of tax (iii) even if a trustee is taxed for the income of the trust, it is taxable only in his capacity as a 'representative assesee' and (iv) even if the trust earns income which is in the nature of 'business income' it is taxable at the trustee level but thereafter income distributed by such a trust cannot be further taxed in the hands of the beneficiaries. These principles effectively would always ensure a single point taxation and in most cases a tax pass-through status for a trust as an investment vehicle.

However, with evolution of trust as a favoured investing vehicles specific provisions granting a tax passthrough has been offered based on the nature of vehicle irrespective of whether they are organised in the form of a company, LLP or a trust and to that extent a company or a LLP can also enjoy a tax pass through, but it needs to be recognised that while these vehicles have been given a 'deemed' pass-through for tax purposes for certain specific use, a trust on the other hand inherently enjoys a tax-pass through by its very nature.

Comparison of a Trust vs. Company vs. LLP

Secondly, a question always arises in the context of choice of investment vehicles as to how is a trust different from a 'company' or an 'LLP' and more importantly when one has a choice of using any of these three vehicles, why does one usually see a trust as a preferred vehicle? There are various aspects which go in favour of choosing a trust over the other vehicles and a summary of some of these factors is tabulated below for the readers, but the core to the answer again takes us back to the nature of the trust. Unlike a company or an LLP which obviously has its own share of benefits and characteristics, a trust being not a statutory body and is essentially a relationship driven by a contract between its stakeholders, it lends itself very well for fund structures involving a fiduciary and a beneficiary relationship between an investor and a manager. Of course there are several other reasons including tax which again in a way go back to core issue of its nature and ensures that a trust by its very nature is treated as a pass-through vehicle let alone any other artificial fiction that the tax law may create e.g. S. 10(23FBA) read with S. 115UB relating to pass-through accorded to Alternative Investment Funds or S. 10(23FC) read with S. 115UA giving a partial pass-through to Business Trusts. Thus, even when the specific pass-through did not exist or was withdrawn partially by the tax authorities, the funds still were able to rely on the general provisions relating to taxation of trusts under S. 161-164 and avail an effective single level tax for their investors. Needless to say, there are other benefits that the trust offers over company and an LLP which still make it a compelling choice of vehicle for business/ investment trusts.

	TRUST	COMPANY	LLP
Organisation	Not a statutory process. Requires a trustee and a settlor. Easier to set-up. No standard constitution.	Statutory process. Requires minimum shareholder and directors. Requires MoA/AoA which comply with the statutory requirements.	Statutory process. Requires minimum two partners. Constitution defined through the partnership agreement which is flexible.
Compliances	No statutory compliances and filings required except those which are arising from the indenture as well as anything which is prescribed by relevant regulations.	Need to comply with Companies Act provisions. No specific carve out generally for investment vehicles. Provisions relating to intercorporate loan, directorship, related party transaction, etc. could become restrictive in a fund scenario.	Need to comply with the basic compliances under the LLP Act, 2012 which are not very prescriptive.
Distribution of Proceeds	Flexible. Completely driven by the trust document and as may be agreed with investors. Profits not necessary for distribution of proceeds.	Rigid. Distribution of profits and capital reduction highly regulated and restrictive. Book profits almost necessary for distribution or buy-back.	Flexible. Distribution driven by the LLP agreement and as agreed amongst the partners. Profits not necessary for distribution of cash proceeds.
Capital Structure	No defined capital structure. Absolute flexibility in defining different classes of beneficiaries with differential rights subject to the terms of the indenture.	Can be primarily in the form of shares or debentures. There can be different classes of shares but it needs to comply with requirements of companies act.	No defined capital structure. Can issue different classes of partnership interest with varying rights subject to the LLP Agreement.
Governance structure	No prescribed governance structure and can be defined under the trust documents creating complete flexibility in designing this.	Need to have board of directors which ultimately takes full responsibility. Appointment and removal to be approved by shareholders.	Need to have two designated partners (individuals) who will be responsible for compliances. Governance structure can be determined under the LLP Agreement.

	TRUST	COMPANY	LLP
Nature of existence	Not a legal entity and trustee represents the interests of the beneficiaries.	A legal entity distinct from its shareholders.	A body corporate which is distinct from its partners.
Winding up	Easy to wind down a trust. No statutory process required.	Need to go through a winding down process as per the Companies Act. Can be long and unwieldy.	May be easy to wind down in accordance with the LLP Agreement.
Taxation	Inherently only one level of tax being a non-entity. Additionally, pass-through under specific sections available.	The company and its shareholders are distinct taxable entities. However, pass-through under specific sections available.	Only the partnership is taxed but the partners are not. However, pass-through under specific sections available.

Rights, duties, obligations, and liabilities of various stake holders in a business trust

Unlike a company or an LLP, where the statute is prescriptive in terms of the rights, duties, obligation and liabilities of a shareholder, key management and directors, the trust law lays down only the broader principles of a trust and a fiduciary nature of the arrangement and leaves a lot of the role, responsibilities, obligations, and liabilities of various stakeholders viz., settlor, trustee, and beneficiary/contributor to be defined under the instrument of trust. This is one strong reason in favour or a trust being a preferred vehicle for a business trust since it can more effectively define, and ring fence the roles of various stakeholders through a contract which then becomes enforceable against each stakeholder through the provisions of the Trust Act.

However, SEBI as a regulator for many of these forms of business trust also clearly define the role, responsibilities and liabilities of the sponsor, trustee, and the investment manager under its relevant regulations e.g., SEBI (Alternative Investment Funds) Regulations, 2012, SEBI (Infrastructure Investment Trusts) Regulations, 2014 or SEBI (Real Estate Investment Trusts) Regulations, 2014, these provisions broadly govern the functioning of these business trusts. One clearly needs to bear in mind that besides the general fiduciary duties arising upon the trustee under the trust law, SEBI regulations additionally impose such fiduciary responsibilities on the Sponsor, Trustee as well as the Investment Manager of most of these business trusts.

The Trustee under the Trust Act must mandatorily ensure that the assets of the trust are managed in a prudent manner and any failure to do so could expose the trustee to potential claims and incur liabilities to the beneficiaries. However, if the settlor while settling the trust instructs the trustee to appoint a certain entity as the investment manager and also to delegate the powers of management to the such investment manager, to that extent the trustee is absolved from his duty of managing the assets of the trust and its role would then only be to administer that the manager is managing the assets in line with the objects of the trust. This has also paved way for the use of independent professional trustees for most of the business trusts even where it is not prescribed under the regulations e.g. AIFs.

As regards the rights of a contributor/ beneficiary, the trust law protects the beneficiary against a basic breach of fiduciary duties by a trustee however unlike a company law, the trust law is not prescriptive as to the specific rights of a beneficiary in a trust. It in fact really leaves the nature of relationship including rights, duties, and obligations of a trustee vis a vis the contributors and vice a versa to be defined under the indenture of trust or the instrument of trust. For e.g. in a mutual fund scenario the unit holders should give away discretion to the AMC to manage the assets of the trust, whereas in AIFs contributors may retain right to participate in some investment decision making or in a securitisation trust, the beneficiaries only have a right to receive the income generated by the trust but no right over the underlying assets. Needless to say, that SEBI or RBI as a regulator from an investor protection perspective or from a market preservation perspective may prescribe additional rights, obligation and duties and the trust law is flexible enough to imbibe many of those without creating a conflict in law. It is really this flexibility of the trust law that makes trust a very versatile instrument to be applied to various situations almost seamlessly.

FEMA Considerations for investing in business trusts

Because of the complex nature of relationship between various stakeholders in a trust scenario, the RBI has always had a cautious approach to dealing with trusts in general. Similarly, under the FDI policy too the Government has always adopted a cautious approach to allowing foreign investment from vehicles which are a trust since it becomes difficult at times to determine the true beneficiary of an investing trust. Having said that, with increasing use of trust vehicles for various investment activities, RBI and the Government has softened its stand for trust vehicles both from an inbound foreign investment perspective as well as outbound investment perspective. One of the benchmarks used by RBI is that regulated trust vehicles such as AIFs, MFs, REITs or INVITS are acceptable forms of vehicle where foreign investment should be permitted. Thus, they have made acceptance of foreign investment permissible in these investment vehicles under the automatic route. However, for any other situations falling outside of these specific vehicles, in general foreign investment in a trust under automatic route remains prohibited and requires a prior approval of the Government.

Further, philosophically the Government has recently changed its stand as to how would they want to regulate these vehicles and their status under FDI policy. Traditionally under the FDI policy, the status of these investing vehicles was determined based on the corpus that they receive and not linked to the status of the manager who managed these vehicles. Thus, the moment there was a dollar of foreign capital that was contributed into such investment vehicles like AIFs, firstly it was not covered under the automatic route and one had to approach FIPB for an approval. While approving the foreign investment, FIPB use to invariably prescribe conditions that such a trust with foreign contribution will need to comply with all the FDI norms irrespective of the level of foreign contribution. This obviously led to even the domestic investors in such vehicles being subjected to FDI restrictions which was not always desirable. However, in a significant shift on its approach towards these investment vehicles, in November 2016 the Government not only opened up these investment vehicles for foreign participation under the automatic route, but also changed its focus to the investment manager and sponsors of these vehicles to determine whether these investment vehicles would be subjected to FDI restrictions on their investments or not. Thus, it follows not that irrespective of the quantum of foreign investment in an investment vehicle (AIF, REIT or INVIT), as long as the investment manager and the sponsor are Indian owned and controlled (more than 50% ownership, right to appoint director and control with Indian residents), such investment vehicle would be deemed to be domestic for FDI purposes and will have full flexibility to invest like any other Indian resident. And conversely, if the manager or the sponsor are not Indian owned and controlled, the investment vehicles would be subjected to foreign investment restrictions. This approach is actually very pragmatic and forthcoming where we continue to welcome foreign investment in the economy and as we inch closer towards convertibility of the Indian rupee. That this approach has generated a significant amount of interest from overseas investors in using the AIFs for undertaking investments into India to get more flexibility on their downstream investments in terms of potentially sectors, instruments and pricings besides a more neutral tax treatment given through tax pass-through.

In respect of investment managers managing these investment vehicles, since the activities fall within 'non-banking financial services', foreign investment in such investment managers is subjected to certain FDI conditions. However, as a liberalisation for foreign investment in the financial services sector in 2017, RBI not only allowed foreign investment in these activities under the automatic route but also removed any minimum capitalisation norms as long as these entities are regulated by a financial services regulator in India. While it was clearly a liberalisation move, it is also important to note that especially in case of the business trusts and especially AIFs, SEBI only registers the fund and not the investment manager and thus whether the investment managers to AIFs would be treated as regulated for FDI purposes. However, after much representation, SEBI has clarified in the context of AIF that even though the investment manager is not registered under the AIF Regulations, they are regulated under the said regulations and based on this, these entities should be eligible to benefit from the sectoral liberalisation.

In Conclusion....

The potential for use of trust as an investment vehicle and its status as a 'business trust' is almost infinite and the construct of the law as mentioned earlier will ensure that this form of vehicle will continue to thrive and encourage creative usage to provide business solutions in the complex investing world. It is extremely important to understand the core principles of trust to be able to use this vehicle not only creatively but also correctly. While the effort in this article has been to lay bare some of these principles in a more simplistic and a practical manner, the jurisprudence on the trust law is rich globally in the common law countries. While many newer choices of vehicles will emerge over the years which may compete with 'trusts' as a choice of vehicle, but as professionals and as advisors, one may always be able to say, 'In trusts, we trust'!

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Every man has in him the potentiality of attaining to perfect saintliness.

— *Swami Vivekananda*

The Dastur Essay Competition 2018, Merit List

Sr. No	Participant Name	Topic	Associates/College
1	**Ms. Krisha Jitesh Sanghvi**	What Swachh Bharat signifies for me and way forward	Hinesh R. Doshi & Co., Chartered Accountants, LLP, Mumbai
2	**Mr. Umang Upendra Gupta**	GST- Boon or Bane	Khandelwal Jain & Co., Chartered Accountants, Mumbai
3	**Mr. Meet Hiren Shah**	Is intolerance growing nationally and internationally?	GBCA & Associates Chartered Accountants, Mumbai
4	**Mr. Manish Agarwal**	GST- Boon or Bane	Manoj Goyal & Associates, Chartered Accountants, Rajasthan
5	**Ms. Bijal Tushar Sanghavi**	Is intolerance growing nationally and internationally?	V.G.Vaze college of Arts, Science & Commerce, Mumbai
6	**Ms. Rucha Chintamani Limaye**	GST- Boon or Bane	ERNST & Young LLP, Chartered Accountants, Pune
7	**Mr. Jay Kishan Sharma**	What Swachh Bharat signifies for me and way forward	National University of Study & Research in Law, Ranchi
8	**Mr. Anirudh Bajpai**	GST- Boon or Bane	Faculty of Law, Banaras Hindu University (BHU), Varanasi
9	**Mr. Sagar Khandelwal**	Is intolerance growing nationally and internationally?	Indira Gandhi National Open University, Jaipur
10	**Ms. Jyoti Bharti**	What Swachh Bharat signifies for me and way forward	Ram Manohar Lohiya National Law University, Lucknow

Krisha Sanghvi

What Swachh Bharat signifies for me and way forward...

"A clean India would be the best tribute India could pay to Mahatma Gandhi on his 150th birth anniversary in 2019..." were the words by a visionary leader, Mr. Modi – The Honourable Prime Minister of the Republic of India, on the 2nd October 2014 – the day when he launched the iconic – "The Swachh Bharat Mission!" As much as this mission was an enlightening endeavour, it was a hard-bitten challenge. On the 2nd October, 2014 – our Prime Minister urged the people of this nation to do something that perhaps they had paid least heed to, he sought help of a hundred and twenty crore Indians who till date were nothing but cynical about this entire issue circling the country's cleanliness. The people of India realized, they had a tenacious grip on their century-old habits and the man standing out there on the podium was expecting more than what was practically deliverable but every Indian out there took this irrefutably and answered his urge with applauds and cheers! Be it the 'Clean Ganga Mission' or '*Swachh Sadak Abhiyaan*', people walked hand-in-hand, shoulder-to-shoulder and marched to every move the newly elected Government was taking.

While, soon in months I saw the nation progressing, people becoming aware about their civic duties more than their rights and although seeing roads neat as a pin, imagining a country as immaculate as ever was yet a far-off dream but if even Rome wasn't built in a day, we'd all also be patient enough to see things, set in motion. And while I see this mission doing well at places, securing its place on possibly every Government-provided utility printed invoice, seeing it getting introduced as a tax-linked cess, if personally asked about my opinion, I see 'Swachh Bharat' from a little different perspective. If the term as it signifies is about cleaning the country and perk her up than never before, I'd say it is also about cleaning the mess that lies within.

With efficacious campaigns and a leviathan mass of countrymen – we might succeed to achieve dirtless roads, a clean Ganga, civilised streets, and a sparkling infrastructure but what about the impractical traditions, unexplained customs, narrow minds and a not really justified devout? Would it be justifiable to call my country swachh without she being free from this menace? Every morning we get up to news filled with scams, people cutting each other's throats in the name of religion, rapes, women-security issues, gender equality issues, and the list doesn't end. While in other countries, news means something new that has or is happening within their boundaries which might include both – good as well as bad. But in our country, news has taken a close enough synonym to being nothing but bad. It has become such an evident synonym, that when a person as simple as one walking on the road if asks the other about the news, there'll only be bad ones reaching out to him. The good ones somehow either don't end up reaching the masses or perhaps the bad ones occupy most of the space in the newspapers, that they don't find enough space to fit in the good ones. The day this nation wakes up to news flowing with nothing but positivity, progress, growth and development – that would be the day I would consider my *Bharat swachh*.

Women in our country constantly live under the social pressure and the fear of security is the first thing hovering over their heads. While a young girl is pressurized to choose what she wear wisely, limits are set over the time of the hour when she returns back home, a married woman is expected to curb her personal desire for growth, and look after the family first. She is given a defined set of protocols to be followed in the society and a stated way to mingle. It is considered deemed and assumed that a girl, right from the time when she is born, she'll do what she is asked to do and give all the sacrifices that she is expected to give. So in our well cultured society, when boys can go around and have the kind of independence they want, girls seldom can do the same. With something as simple as going for a late night movie show, when a boy has to think nothing about but which flavoured popcorn he'll be relishing or which theatre he'll be going to, a girl will have to think about alot many more things. To state a few – What should I wear so that no boy looks at me with eyes that might hamper my security? If I go with a guy friend and if my neighbour sees it, what will they think? What if someone sees me coming back home at two in the night, what will they assume? Will it really be safe to travel in a taxi at that time of the hour? If going for a movie happens to be so complicated, we can very well imagine how difficult it would be to deal with other major issues for them! When women will share an equal space with men, when women will have an equal say in the crowd, when they won't be seen as objects but considered the strength of our society, when girls won't have to think twice about their attire or their way of doing things, when women will be given a fair chance to prove their worth, to give importance to their personal growth, when marriage won't be a barrier for them to sit back within the four walls, when woman will be given an equal chance to work, when the century-old restrictions imposed upon them will no longer be imposed, when they'll be applauded and valued for all that they do, when they'll be appreciated and bowed down for the sacrifices they give, when their security won't be a fear anymore, that will be a *' Swachh Bharat'* for me!

When the lust of a few men spoil the life of a woman, when rapes happen at a faster rate than the birth rate of women, when just to avenge a girl's rejected she is attacked with acid, when obsessed love takes away a girl's life, the society merely sits back and enjoys the show! In spite of the entire country being aware of what and who is wrong, the rape victim in turn is held responsible. It takes tremendous valour to stand up and speak against what's wrong! And when a girl shows such valour, she is made to sit at the police station for hours just to record her statement. The rape victim is excommunicated from the society. Why does that happen? What was her mistake? No one ever has an answer. When rape will be considered a crime attracting the heaviest capital punishment, when the rape victims won't be excommunicated but supported by millions, when men will start valuing the life of women, when the rate of rapes happening in India will fall down to an absolute figure of zero, that will be a *'Swachh Bharat'* for me.

Corruption is spreading like wild fire in this country. Every one, right from a government officer to a minister, are in some or the other way corrupt. It has become a tradition, a well-set culture to get things done with bribe. Imagining things getting done without a penny is a far sought out dream. The entire concept of corruption grounds down to greed. Because there is greed, there is a need for money! Because there is a need for money, there is a hunger for power! Because there is a power for hunger, there is an attraction to become a minister! The government is trying in many ways to deal with corruption on a large scale but it is us, the people of India who have to join the efforts hand in hand. It is because we offer; they enjoy taking more of it. The council of ministers are for the service of the people. They are the leaders of our country; they should work towards progress of the nation and not filling their own pockets. When this country will awaken to this wrong-doing, when they'll decide to unite and roar in refusal to spend not even a single penny in bribes, when the government officers, ministers undertake their office as a responsibility and not as a money minting machine, when this nation will be labelled as a –'Corrupt-free country', that will be a *'Swachh Bharat'* for me.

Talking about corruption, politics at the same time has a very different meaning in our country. While when the constitution of our country allows a multi-political party system, it has created a menace in the recent past. While politics is a way of contributing to the nation's progress by being an active part in its functioning, in our country it appears to be a power-rich authority. People take up politics for their own personal interests, and in achieving so, it doesn't take them much time to sacrifice the nation's interests in front of their own. India happens to be the largest democratic country in the world and the Lok Sabha elections are a treat to watch, every five years. People all around the world give a hefty slot in their news channels to cover the election campaigns. Western countries in their well-clad style define the Indian elections as – 'The largest show on earth where a hundred and twenty crore Indians vote for five hundred and twelve seats!' But only we know what happens inside. As soon as we are a year away from the general elections, all the major political parties come out with their own set of manifestos, their own set of promises which end up being nothing but a piece of paper post their victory. When this nation will see politics as a constructive way of functioning the government in an honest and righteous manner, when each and every countrymen will attempt to step their feet inside the puddle and not merely sitting at a distance and criticizing the system, when the basic criteria of standing for election will be amended with a clause which would state, 'The Member-Representative needs to be educationally qualified', when the youth will take over the mettle and surge forward to carve out a young Indian enthusiastic government, when the voting rate will be cent percent and every countryman's finger will be inked with pride and honour of contributing their part to the betterment of the nation, it will be then what will be a *'Swachh Bharat'* for me.

Having talked about politics, the parliament being the place where the law makers find haven, happens to be one of the most disturbed places in the country. Where the ruling sits to pass bills under their banner and create history, the opposition sits to yell and shout to oppose that happening. The commotion reaches at its peak almost every time there is a major bill presented and the speaker is left with no option but to adjourn the sitting. And then we sit back and wonder how GST took two long years to become an Act. While it is estimated that every sitting of parliament costs a lot many lakhs, adjourning the sittings leads to nothing but a criminal waste of public money. As per the law, every member needs to apply to the speaker in writing about his desire to present his speech in a particular sitting and on approval, he is granted a defined set of few minutes to put his view forward. While when the members are gifted those few minutes to speak, it would be a wise thing to put in front of the house, the difficulties that their respective constituency is facing or for that matter if they wish to do something specific in their respective constituency or bring about a change in the functioning of the government. However, all they end up doing it nit-picking on their opposition's doings, commenting on how things are functioning under them and this in the end, yields out nothing productive. In Dr. APJ Abdul Kalam's witty words: 'This nation needs to understand the power of democracy and constructive discussions. If the parliament resorts to more of constructive discussions rather than opposing each other, India will reach new heights of success!'

And that is exactly what the law makers need to understand – the power of democracy and the magic of constructive discussions. If there are issues in a particular bill, wouldn't it be more fruitful to hold a joint meeting or cross-placing some alternate views rather than breaking chairs and shouting the throats out? In a country so varied and vast, constructive discussion is the only way to bring out a win-win situation, the end-goal being growth of the nation. When the law makers will resort to healthy debates, when every law maker will respect the view of the other, when there will be thuds on the benches with the hands of all signifying the view each one of them puts before the house, when the rate of adjournments will fall down to zero, when India will become the fastest country in passing bills and making laws, when India will have a house full of educated young minds, it will be then when India will be a '*Swachh Bharat*' for me.

Having said about that, evading tax is a major revenue leak for the government and in spite of varied efforts, it is never possible to be cent percent fully equipped with a mechanism to bridge this leak. The only way to seal this leak is to change the mind-set of people, to change the way they see and perceive the concept of tax. Tax was introduced with the guiding principle which said: 'Give us ten and we'll give you back a benefit of twenty!' Tax was introduced with a view to take a cut from the people's earnings for their own betterment and the development of the country. But the way we see it in India, people see tax as the biggest burden over their heads with no future or enduring benefits. People in India see Tax as a sunk cost when in reality it is a deferred expenditure with promising returns and benefits. In countries like Denmark, the Tax rate is high as fourty-five to fifty percent. The young crowd have to bear a tax burden of as high as almost half the income they earn. In return, the government promises them a secured life post their retirement. So, once they retire their entire expenses are borne by the government. It is that government's way of giving back what they have taken from the people, and the benefits people get are way more than what they've spent as their tax expense. The people of Denmark are so well convinced with this concept that evading tax is never an option for them. Even if given an option, they choose to disown the option of evading tax, for they are convinced of getting enduring benefits from the government when they'll have no running income. In India, because people evade tax – the government falls short of revenue and in turn that develops a limitation in what they do for the public at large, which could have been way more if the people would choose not to evade tax. It is because of this reason, government needs to resort to a deficit budget almost every fiscal and as the interest cost increases, inflation increases. When the people of this nation will understand the concept of taxation, when the people will be convinced of promising benefits on them paying taxes, when people will partner in creation of a cash-less economy, when the countrymen will furnish honest returns and show their income transparently, when the penalty sections will remain just in the books and would never need to apply them in real, when the concept of black money will be uprooted from the Indian soil, when India's budget will turn into a surplus one, when India will become the highest tax collecting country in the world, that would be a '*Swachh Bharat*' for me.

When Mr. Jawaharlal Nehru's words when he'd said, 'The appointed day has come— the day appointed by destiny—and India stands forth again, after long slumber and struggle, awake, vital, free and independent. The past clings on to us still in some measure and we have to do much before we redeem the pledges we have so often taken. A new star rises, the star of freedom in the East, a new hope comes into being, a vision long cherished materializes. May the star never set and that hope never be betrayed! We have hard work ahead. There is no resting for any one of us till we redeem our pledge in full, till we make all the people of India what destiny intended them to be. We are citizens of a great country on the verge of bold advance, and we have to live up to that high standard. All of us, to whatever religion we may belong, are equally the children of India with equal rights, privileges and obligations. We cannot encourage communalism or narrow-mindedness, for no nation can be great whose people are narrow in thought or in action!' turns out to be true and personified, when gender equality won't just be a term anymore, when my countrymen will be educated, when freedom of speech won't be taken advantage of, when religion won't create difference between people, when every religion, creed and sect will be respected and seen upon equally, when castes won't define the dignity of people, when people's mind will be open and free, when India will be counted amongst the first world country, when India will be ranked on the top list on the 'happiness' index and considered as a 'happy' nation, it would truly be then when I would consider her as *'Swachh Bharat.'*

Having said and opined my personal views on what would really be a *'Swachh Bharat'* for me, it should be considered wise to consider the cost associated. Every dream has a cost and every cost needs to be backed with a plan. Every major revolution requires investment and every investment requires funding in a viable manner. If this is the dream which I personally see of shaping my country as, it would also involve a heavy cost to make it a reality. The Swachh Bharat campaign has already been launched on a massive scale and it involves a hefty amount of public expenditure, a remarkable part in the government budget, a notable tax cess which though now stands redundant but was successfully implemented from 1st June 2016 to 1st July 2017 with the connotation – the Swachh Bharat cess charged along with service tax. But the dream of Swachh Bharat which I have seen would require a lot more in terms of resources and finance. It would require the government and the countrymen to come out with various innovative ways to help the *Swachh Bharat* movement surge forward.

The government, every year allots a part of its budget to the Swachh Bharat mission. It sets aside almost a thousand crores for the successful implementation and functioning of the flagship campaign. The focus majorly lies on keeping the country clean but cleaning the minds of the countrymen would require a much heavier investment. So if asked for my personal view, I would suggest the government to save even the thousand crores which it sets aside for this campaign. Rather, it can very well earn a minimum interest of 5.5% on the slated amount which right now would be taken as an opportunity cost. It would also be a suggestion to the government, to avoid introducing the required cost as a tax, which would ultimately burden the countrymen with more tax flowing out of their pockets.

Allowing myself some liberty to put my views forward, I would suggest the government to resort to various innovative ways and means to make this campaign altogether more lucrative and attractive. The people can be made more aware and responsible about their responsibilities towards the society by introducing a concept which could be connoted as – The Swachh Bharat reward program. As per this program, the people should be first encouraged to do their duty in keeping the country clean. On successful achievement of their part, they should be rewarded some points. The entire program should be IT-enabled and every person would require to make an account on the slated application to claim their rewards. Once they achieve their part, some points should be credited to their wallet which they can redeem against purchasing whatever they like. If the private companies are reluctant to join hands in this program, the government themselves can take the initiative. If a person successfully accumulates a particular amount of points in his wallet, the government can reward him by giving him a discount on the liability of taxes which he is expected to bear. Let's take for an example – a person undertakes the responsibility of keeping the street joining his house clean by regularly sweeping it and keeping it free from garbage, the government would credit 100 points per week to his wallet on successfully verifying his claim. His claim could be certified by a Chartered Accountant or for that matter any competent professional after physically verifying the said area. Once his claim is verified, he would earn 5200 points in a year (52 weeks times 100 points). The government could then allow him to redeem these points and set-if off against his tax liability. If not entirely, a certain defined portion of it. This would turn out to be a cost for the government in terms of the tax that it would have to forego but at the end, it would be a win-win situation for both of them. The government wouldn't have to set aside a defined sum of money to carry on the functioning of this campaign and the person would at the same time, feel more motivated to take care of his responsibilities because he would be fairly rewarded for the efforts which he would be taking. While the government would achieve its purpose, the person too would be feel involved in doing his part for his country.

Another innovative way, what the government could resort to is – giving extra tax exemptions and benefits under the Direct tax regime to encourage people to take this movement forward. Apart from the regular tax exemptions, the government could give the people some lucrative schemes under the tax system. Some of them could be – if a particular company keep the area around it, clean; if it undertakes the responsibility of beautification of the area, educating the unfortunate living in the vicinity, helping the people get rid of hunger by providing them food, providing aid during the time of natural or man-made calamities, the government would give such companies a tax holiday for a certain defined period of time.

Over and above, the government could also provide those companies with some benefits like supplying the basic amenities to their factories at subsidized rates. This would encourage the companies to do their part towards the society and the government would be free from the worry about developing those areas. Over that, the cost that it would incur in developing areas would be much higher than the tax which it would have to forego.

Another way to attract big business houses to undertake an equal footing in this iconic program could be – 'A star rated program!' As per this program, if a business house undertakes to adopt the area around which it is situated entirely and help it develop and grow, the government would give them a rating on the basis of stars based on the work that they have done. The rating would be on a scale of one-to-five, five being the highest. Based on the rating and the number of stars they get, the business houses would get some special privileges from the government in the form of a reduced tax rate, government subsidies, greater export incentives, government tenders, etc. So, for example if a business house is situated in the backward area of Manipur and it adopts a particular area, constructs a school there, brings clean water to the people, undertakes to keep the entire area clean, conducts various awareness programs, educates the people on the concept of having an open mind towards religion, provides employment on a mass scale, and on the basis of this work done, the business house gets a four-star, then probably the government could provide them tax concessions by charging them 25% instead of 30%. The government could also give them an annual subsidy, sign a tie-in agreement for recurring purchases, provide them export incentives over and above the regular ones. In this way, the business houses would be attracted to set up their plants in the backward areas, with a view to availing such benefits, they would develop the entire area and what would normally cost the government hundreds of crores to do the same, it would achieve its objective by getting it done by a business house.

There could be a lot many more innovative ways out to develop a Public-Private Partnership for this program. India is a potentially strong country rich in its heritage, culture and traditions. It is our responsibility to preserve and protect the same. In a nation with a hundred and twenty crore countrymen, each one of us should consider taking a vow to preserve the rich culture of this diverse nation. It took us years but now that we've been aware about the importance of keeping our nation clean, let's do it entirely from outside as well as from inside. If we are now giving importance to keep our streets clean, let's give importance to keep our minds clean too. And this responsibility will have to be shared amongst all of us. It wouldn't be anywhere right to expect the government to everything for us. After all, government is nothing but just a public body by the people and for the people. If government has taken an initiative to make India newer heights, we as the responsible citizens of this great nation too, need to take an initiative to change our attitude towards certain things, to adapt to the change which is for the good, to stop spitting on the roads or littering our streets! It is time to move towards a path which is promising us development and growth. It is time to stop fighting in the name of religion and caste. It is time to stop pushing each other down and being concerned with just our own self-growth. It is time to stop evading tax and not giving the government what it rightfully deserves. A rupee spent in taxes, will come back to you as ten rupee earned for your own betterment. It is time to stop criticising the government, its mechanism, its council of ministers or for that matter its officials. They'll change, the day we change. Indians are looked upon as people who can do wonders throughout the world. Be it Sundar Pichai, or Satya Nadella, be it Ajaypal Singh Banga or Indra Noyi – Indians have gone abroad and proved their mettle. But the hardened fact is these great people had to travel places to prove their worth. Is it because their own country didn't give them enough space and opportunity to grow to the level, they wanted to? Well, sadly yes! So now is the time to develop our own very nation is such a way that any Indian who wishes to prove his self, nothing but sky would be the limit for his ambition. Just keeping ganga clean won't signify a successful Swachh Bharat abhiyaan, but having an open mind, tolerance towards each other, respect for each other's religion, getting rid of the century old meaningless customs, surging towards a safe, content, ever growing, ever expanding, path breaking, innovation inviting India would truly personify and sum up the Swachh Bharat mission. So to conclude in my words – when India, the almighty India – a nation with a population of 1.2 billion, the seventh largest by area in the world, the sixth largest economy in the world, with tens of religions, and hundreds of languages – will rise to a poverty-free, a corrupt-free, a pollution-free country, when she will out beat Denmark in its happiness index, when the entire population will be considered educated and just literate, when men and women will match shoulders in every sphere of life, when infant mortality will be an unknown phenomenon, when the nation's GDP will define new heights and set new benchmarks, when people won't slit each other's throats in anguish, when my countrymen will be under no kind of agony, when smiling faces will be a most watched phenomenon, when politics will see a new dawn, when politics will find its new meaning, when law makers of our country won't need the back support of the bureaucrats, when every kind of job will be considered of dignity, when India will be called the 'Golden Sparrow' all over again, it will be then when I'll say – Yes! Yes, this is exactly what *Swachh Bharat* means to me! And to further conclude in Mr. Rabindranath Tagore's wise words:

'Where the mind is without fear and the head is held high,

Where knowledge is free

Where the world has not been broken up into fragments by narrow domestic walls Where words come out from the depth of truth

Where tireless striving stretches its arms towards perfection

Where the clear stream of reason has not lost its way into the dreary sand of dead habit

Where the mind is led forward by thee into ever-widening thought and action

Into that heaven of freedom, my father

Let my country awake!'

Bibliography

www.google.com

(For the extract of the poem)

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TECHnovation

One Year of GST – A Technology Perspective

On 30th June, India completed one year of GST rollout. GST was India's first paperless, digitally administered tax. The rollout witnessed its fair share of ups and downs. The World Bank called it one of the most complex systems in the world. While it caused disruption during its initial days, it has since then stabilised.

In this article, I am giving my perspective on how the new regime has played out, mainly from the technology perspective.

The formalisation of economy: A huge data repository

The Economic Survey 2018 had a special chapter dedicated to GST: A New, Exciting Bird's-Eye View of the Indian Economy through the GST. The GST data has started providing important facts about the Indian Economy, which hitherto was extremely difficult, if not impossible. Some of the findings of the Survey are:

- The share of inter-state trade of goods is 60% of GDP. Earlier surveys had estimated this to be between 30% to 50%.
- Voluntary registrations under GST stood at 17 lakh. These are enterprises below the threshold of 20 lakh.
- 19 Lakh persons were entitled to the composition scheme but chose not to avail it and chose regular return filing.
- There was a fear that shift to a consumption-based tax would shift the tax base away from the manufacturing States. However, the data provided 95% co-relation between Gross State Domestic Product and Tax Base.
- For the first time, it was possible to know the share of exports by individual states. Five States, Maharashtra, Gujarat, Karnataka, Tamil Nadu, and Telangana, in that order, account for 70% of India's exports.
- One of the biggest findings was in respect of employment data. India's formal non-farm payroll is substantially greater than currently believed to be about 31 per cent of the non-farm workforce.. Post GST data, the non-farm payroll share is indicatively around 53% of the total.

GST Eco-System – Envisaged versus Reality

The Goods and Services Tax Network (GSTN) was entrusted with the task of creating the Information Technology (IT) infrastructure for GST. It worked with India Stack (a digital Infrastructure to solve India's hard problems towards presence-less, paperless, and cashless service delivery) and was inspired by Aadhaar which enabled multiple public and private applications to flourish. It built the Open-

Application Programme Interface (API)-Platform which would be used by GST Suvidha Providers (GSPs) and Application Service Providers (ASPs) to build innovative solutions to the large and growing taxpayer base.

GSTN was formed as a private company which would able to hire talent from the private sector and has the ability to react fast to emerging situations

All existing return filing systems like income-tax and VAT faced the problem of last moment filing which led to slow/no response from the central server. GSPs are expected to provide a remedy to this situation by distributing load away from one single server. ASP's are expected to provide solutions to taxpayers, so that complete load does not fall on free software provided by GSTN.

Any IT system needs time to deliver functionality. As GST rolled out, Government made drastic changes in rules and GSTN was pressurised to respond to these changes, which affected its execution ability.

GSTN also came up with its own free return filing platform and utility. With each passing month, the problems kept worsening and GSP/ASP ecosystem too had to bear the brunt. GSPs/ASPs were impacted because of three major reasons:

- GSTN introducing new functionality and enhancements on the GST portal ahead of APIs.
- Inconsistencies between return filing experience on the GST portal and through APIs. Such inconsistencies led to an erosion of trust of customers on ASP and GSP solutions.
- Lack of adequate documentation on API interface which is essential for software development of ASPs and GSPs

Through an open and transparent selection process, GSTN approved 34 GSPs in December 2016 and 39 in August 2017. As per one GSP, annual expenditure to run IT infrastructure: server, MPLS Lines and ISO Audit alone would be approx. ₹ 40 lakh.

Today, not more than 12-15 GSPs are active as the whole business has become unviable for them.

Improving Compliance Levels

Compliance levels were very low initially due to confusion, lack of understanding and technical glitches. However, these have gradually improved as can be seen below.

Month	Required to File	% Filed on Due Date	% Filed till March 2018
July 2017	66.47	57.69	96.1
Dec 2017	81.22	66.81	83.08
March 2018	87.15	63.63	64.61

Source : http://pib.nic.in/newsite/PrintRelease.aspx?relid=178962

Return Filing: Technical glitches

GSTN provided a free return filing utility and online platform to file the return. It conducted several webinars (in English and several other regional languages) to train tax-payers. However, initial run was marred by

- Slow system, leading to a crash
- Frequent message "Failed to establish connection to server" or "system seems to have encountered an error"
- No facility to edit erroneously entered value after "Submit" button has been clicked. This was a major change for tax-payers who were used to edit/amend returns under existing laws. Later a facility to view and reset values was provided
- No way to offset cash balance against different head was also a major problem for non-excise taxpayers. Several assessees paid IGST instead of SGST+CGST and were made to again pay the amount under SGST+CGST to offset liability

With GSP+ASP ecosystem not taking off, the complete load of return filing was shifted to GSTN portal and utility. The hue and cry against technical glitches grew so loud that government had to appoint a special group of ministers to look into the technical issues and suggest remedial actions. Till then, invoice matching has been suspended.

Too many changes left everyone confused

While Government responded quickly to emerging situation by amending rules or keeping them in abeyance, this caused a lot of confusion among tax practitioners and taxpayers. Few such examples

- GST on advance
- Reverse charge on supplies from unregistered dealers
- Provisions of TDS and TCS

The number of Notifications, Circulars and Orders issued under CGST and IGST during July to June is an astounding 338 (246 Notifications, 78 Circulars and 14 Orders)

Going Forward

Government is taking several steps to address these problems. Some of these are:

New Simplified system of return filing

In May 2018, GST Council unveiled a new simplified return filing process which is likely to be launched by September end

- One single monthly return to be filed by regular taxpayer. Composition dealer to file quarterly return. Return details will be much simplified. Due dates will be staggered based on turnover.
- Only seller to upload sales invoice. Buyer would be able to see details of uploaded return on daily basis. No need to upload purchase return. Hence, there will be a unidirectional flow of invoices
- Seller to upload invoice details. The system will auto calculate tax liability
- Buyer to get automatic input credit based on invoices filed by the seller
- Barring exceptional cases, buyer will not be denied input credit for non-payment of tax by seller
- The new system will be introduced in 3 phases for a smooth transition

Phase	Period	Feature
Phase I	Till September 2018	The present system of GSTR-1 and GSTR-3B will continue
Phase II	October to March 2019	New Single Return System with a facility to claim provisional credit
Phase III	April 2019 onwards	Invoice matching on monthly basis

Free Accounting and Billing Software

For taxpayers with a turnover of up to ₹ 1.50 Crore, GSTN is now proposing a system whereby a free billing and accounting software will be provided to such taxpayers. Total 5 software vendors will be selected via a transparent technical and commercial evaluation process.

Total 43 bids were received and 18 have been found suitable for empanelment. The selected vendors will not only provide software but will also provide upgrades and customer support including email and telephonic support.

These software vendors will be paid by GSTN based on bid rates per return filed via the software. This system will be implemented once the new system of return filing is in place

Data Analytics to check tax evasion

GSTN has already started utilising data analytics to check cases of under-reporting of sales, matching of e-way bill data with tax return etc. It is floated to an RFP for a fraud analytics provider. Once such an organisation is in place, it will be able to detect complex fraud patterns.

Conclusion

Looking back, in spite of very complex structure and technical glitches, most stakeholders are of the opinion that GST regime has stabilised. Rising GST collections are even pointing towards improved fiscal deficit target.

Simpler return filing process, invoice matching, coupled with fraud analytics will play a very important role in achieving this target.

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CA Bakul B. Mody

HOT SPOT
One Year of GST – Key Takeaways

1. Preliminary

Looking back to the eventful year since the introduction of GST - the "Biggest Tax Reform" in India, all stakeholders do have reason to cheer. The Big Reform which was expected to create chaos and uncertainty in the initial stages, based on international experience & the complex federal structure of India, now shows some signs of settling down. The credit for this goes to the Country's Leadership, Government Officers (Centre & States), GST Council and to the taxpayers of India. It is not that, it was a smooth run from day one, as it had, and still has, its share of uncertainties and confusion. However, the speed with which the administrators responded to deal with the issues that arose is commendable. The Government ensured that the communication was quick and thanks to social media platforms and timely notifications *via* press releases along with FAQs, the process was smooth and transparent. Formation of the GST Implementation Committee by the GST Council helped in the quick governmental response to address systems & operational difficulties faced by businesses. With the world watching, the Indian Trade and Industry once again proved its resilience to change, by successfully adopting a complex tax regime in a short period of time.

In the long run, GST is expected to considerably reduce corruption, close avenues for generating black money and contribute to ease of doing business though at the cost of a relatively complex compliance requirement. Maybe that is the cost we have to pay, to usher in a paperless, digital compliance regime.

However, as discussed hereafter, there are many concerns (legislative, procedural & system related) which still need to be addressed.

2. Positives

2.1 One Nation One Tax

A consumer from Kashmir to Kanyakumari now pays the same tax on an item. GST has also allowed businesses to streamline distribution systems production, supply chain and storage to make them more efficient, having previously been forced to design them keeping State taxes in mind.

A plethora of taxes and multiple cesses have been subsumed into the GST, aligning India with global tax regimes. Central taxes such as Excise duty, Services tax, Countervailing duty and State taxes – including Value Added Tax, Octroi and purchase tax – were all rolled into one. The new regime provides for free flow of tax credits and plans to do away with cascading effect of tax on tax, resulting in reduced prices for consumers. It also ensured a single law for the whole country with uniform procedures and rules, which reduces compliance burden and business complexities.

2.2 *Single National Market*

Long queues of trucks at State borders have disappeared as check-posts were dismantled, creating a seamless national market. In pre-GST regime, these restrictions had acted as barriers on free movement of goods across the country, leading to huge delays and increasing transaction costs for the logistics sector, eventually translating into higher costs for consumers.

2.3 *Inflation*

It was widely feared that GST would cause inflation to rise, as was the case with many countries that launched a single tax regime. That hasn't happened in India. The much criticised multi-slab structure ensured that the levy was as close as possible to the existing rate, which meant the incidence of tax didn't rise significantly. Further, though the anti-profiteering authority body was set up after the GST rollout, the prospect of its establishment was enough to ensure businesses did not significantly abuse the transition.

2.4 *Tax Base*

One of the expected benefits was that GST would encourage 'formalisation' of the economy. Tax evasion would be reduced, thanks to transparent digital processes, incentive of input credit and invoice matching. With the number of registrations crossing 10 million (which includes new entities in excess of 4 million), it seems more businesses are signing up for GST. Rise in the Employees' Provident Fund Organisation subscribers' base & more people filing income-tax returns can be partially attributed to GST.

2.5 *E-Way Bill*

The E-Way Bill fared badly initially, with systems unable to take the load. However, the government quickly deferred it and came back better prepared. It has now been rolled out successfully nationwide. Eventually, the E-Way Bill System would help curb tax evasion and boost GST revenues.

3. Negatives

3.1 *Compliance*

The biggest problem that the taxpayers faced during the transition phase was that the GST Network (GSTN) could not keep up with the speed at which the GST Council responded to tax payer's grievances, which resulted in frequent changes to the e-compliance modules.

The initial response to the compliance platform designed by GSTN was that it was too complicated. Also the initial hiccups in the GSTN portal added fuel to the fire. The hue and cry generated knee-jerk reactions from the Government and in an effort to assuage tax payers, GSTR 2 and GSTR 3 were suspended and replaced by GSTR 3B, with the Government promising further simplification of returns and eliminating the invoice matching requirement in the next few months. Meanwhile, the industry too developed a comfort with the present system and has gradually started realising that, the matching concept of purchase and sales invoices would be beneficial and would protect them from future disputes and penalties.

3.2 *Registration*

Multiple registration requirements (particularly in case of pan-India service providers & SME businesses) have resulted in hardships for industry and tax-payers generally, which was expecting simplicity. In many cases, registration is required in all States. Businesses fear that multiple audits and assessments due to multiple registrations could make life more difficult for them going forward.

3.3 *Tax Slabs*

The original criticism of a too complicated tax structure with multiple rates remains unaddressed. There are as many as many as six tax rates. Too many rates lead to classification issues and tax disputes, distracting from the simplicity of a single tax that GST should ideally have been.

3.4 ***Refunds for exports***

The refund mechanism for exporters, including data matching law, besides procedures governing them, have irked the sector, particularly SME entities that saw their working capital requirements rise. Though several efforts have been made to address the issue, it requires more intervention, so as ensure that the stated policy of the government that "we should export our goods & services and not taxes" is achieved and Indian businesses remain globally competitive.

4. Concerns / matters which need to be addressed

4.1 ***Advance Ruling Mechanism (AAR)***

One of the important objectives for introduction of GST was to minimize litigation & bring tax certainty for trade and industry. In the recent past, many Advance Rulings have been passed by various authorities across the country, which look to be against the letter and spirit of the GST law and which are causing a lot of uncertainty in trade and industry.

Some of the Advance Rulings that have been issued in the recent past do not capture the essence of the provisions that they called upon to interpret and, as a result, they have ended up unsettling years of settled practices that had evolved under the erstwhile Indirect Tax Laws. The tax treatment of various practices and transactions should largely remain the same on implementation of GST. Any major shift in the tax treatment may end up threatening the very existence some of the well-established business practices or transactions. This would be contrary to one of the important objective of GST introduction to minimize litigations and bring tax certainty for trade & industry.

In a few cases, on the same issue Two State AAR have expressed divergent views [e.g.: two Rulings from the Maharashtra AAR, have favoured a rate of 18% on installation of Solar Plant by treating the said installation as a Works Contract. However, the Karnataka AAR has ruled that installation of Solar Plant is to be taxed, at the concessional rate of 5% applicable to equipment]. Similar issues having significant impact on businesses are likely to arise in large number of cases.

Advance Rulings call for a very thorough application of judicial and technical expertise inasmuch as they have far reaching implications. In the present AAR Mechanism, State wise, the AAR are being manned by middle level tax officers (Centre & State) & AAR Appellate Authorities are manned by Principal / Chief Commissioners (Centre & State). Based on the initial experience, the trade & industry feels that, present AAR Mechanism under GST needs to be revisited (by constituting National AAR with Regional Benches consisting of members with high judicial experience & technical expertise) so as to advance the laudable cause of GST & spirit of GST Reform,.

4.2 ***Legislative Challenges***

Advance Rulings are being sought by tax payers in large numbers accross the country. Concerns therefrom have been discussed in Paragraph 4.1 earlier.

Further, despite issue of FAQs / Clarifications by the Government from time-to-time, writ petitions have been filed across the country in large numbers on interpretation issues. This is likely to result in extensive round of litigations & tax uncertainty which goes against the spirit of GST.

Based on detailed representations made by the trade & industry and stake holders from time to time, government needs to speedily address the interpretational issues [e.g. Scope of Supply, Place of Supply Provisions, Input Tax Credit, Valuation, Dual taxation of IGST & Reverse

Charge, etc.], through appropriate legislative amendments in GST law/clarifications to avoid extensive round of litigations.

Pending legislative amendments, Detailed Clarifications should be issued by CBIC (as was done through issue of Education Guide under Negative List Services Taxation) including Sectoral FAQ (as has been recently done in case of Banking & Financial Services Sector). This would provide clarity to Trade & Industry and minimise litigations.

4.3 *Tax Base*

There are many goods that are still outside the GST net, which comes in the way of seamless flow of input tax credit. Key items outside its ambit are electricity, alcohol, petroleum goods and real estate. Consensus needs to be built to broad base GST within a specified time frame.

4.4 *Tax Slabs*

There are as many as six slabs, excluding exempt goods. Though most goods fall in the 12%, 18% and 28% brackets, there is a case for merging slabs to reduce complexity and classification disputes. The 12% and 18% bracket could be merged into one single slab in the 14-16% range.

4.5 *GST Returns*

This is the biggest item on the agenda dealing with compliances as far as businesses are concerned. The Government has already taken an initiative in this direction with the proposed consolidation of all periodic returns into one. The committee set up for this task has been working on the new format and the IT-related changes required. A new and simplified return filing process should be made effective in consultation with stake holders & after satisfactory test runs.

4.6 *SME Sector*

It is widely known that the SME Sector (including non–profit bodies, Co-operative Societies etc.), operates with a very limited infrastructure. However, the SME Sector contributes a sizable number of the total registrations under GST. Considering the peculiar business scenario in the country & circumstances under which the SME Sector Operates, its significance in the Indian Economy and practices prevalent worldwide, it is recommended that, a Comprehensive Code should be put in place for SME Sector which should, in particular, include provisions for quarterly compliances, removal of hardship provisions under Input Tax Credit and summary assessments

5. Conclusion

A Tax Reform of the magnitude of GST is bound to result in many issues during the initial stages of implementation. Everyone appreciates that, it is not a small achievement to successfully introduce GST, in a large federal country like India. Even more challenging is to introduce a paperless digital compliance and tracking system through e-returns and e-way bills successfully.

However, in order to ensure that the laudable objectives of GST are duly achieved, concerns of Trade & Industry (Legislative & Compliance) should be speedily addressed by the Government(s).

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> The easiest way to make ourselves happy is to see that others are happy.
>
> — *Swami Vivekananda*

  

CA Vispi T. Patel, CA Kejal P. Savla & CA Amol Mahajan

HOT SPOT

Permanent Establishment – Analysis of Recent Rulings

A. Introduction

The development of telecommunications and the internet has created new channels to do business globally in a seamless manner, and in many circumstances eliminating physical presence. This evolution of new business models, pose challenges to the tax authorities in taxing profits emanating from such business, while applying the traditional concept of determining whether a trade or business has presence in a country, through a permanent establishment (PE).

The below article analyses the recent rulings of Authority for Advance Rulings, New Delhi (AAR) in the case of MasterCard Asia Pacific Pte Ltd, In re.[1], and Delhi Income-tax Appellate Tribunal (Special Bench) (ITAT SB) in the case of Nokia Networks OY[2], in relation to the determination of a PE in India.

B. MasterCard Asia Pacific Pte. Ltd., In Re.

The AAR ruling in the case of MasterCard Asia Pacific Pte Ltd, In re., deals with the issue of determination of a PE in India, as regards the use of a global network and infrastructure, to process card payment transactions of customers in India and other connected issues.

1. Facts of the case

MasterCard Asia Pacific Pte Limited (the Applicant), being one of the leading global payment solution providers is engaged in facilitating financial institutions, businesses, merchants, cardholders and governments worldwide, to use electronic forms of payment.

The Applicant charges its customers: transaction processing fees relating to authorization, clearing and settlement of transactions and other ancillary charges as per the terms of Master License Agreements. The transaction processing activity consists of electronic processing of payments between banks of merchants (acquirer bank) and banks of cardholders (issuer bank) through the use of MasterCard Worldwide Network (the MasterCard Network).

1 [AAR No. 1573 of 2014] / [2018] 94 taxmann.com 195 (AAR - New Delhi)

2 [ITA Nos. 1963 & 1964/Del/2001] / [2018] 94 taxmann.com 111 (Delhi - Trib.) (SB)

The Applicant provides a customer with a MasterCard Interface Processor (MIP) that connects to the MasterCard Network and processing centers placed in India and outside India. An MIP is about the size of a standard personal computer and is placed at the customers' locations in India. The Applicant is able to facilitate the authorization, clearing and settlement of payment transactions through the network and processing centers.

The Applicant has a subsidiary in India, namely MasterCard India Services Private Limited (MISPL), in which it owns 99% of the shareholding.

2. Issues

The major issues that arose before the AAR were, whether the Applicant has a PE in India under Article 5 of the India-Singapore Double Taxation Avoidance Agreement (DTAA) and whether the fees received by the Applicant from the Indian customers comprising of transaction processing fees and other ancillary fees would be chargeable to tax in India as royalty or fees for technical services (FTS) as per Article 12 of the DTAA.

3. Ruling of the AAR

a) The AAR after hearing both the parties agreed with the revenue's contentions and held that various digital and connected equipments located in India can create a PE in India. Furthermore, to create a PE, the AAR held that the fixed place does not mean that the equipment should be fixed to the ground. It further held that the transaction processing activities constituted important functions performed by MIPs. For this reason, the AAR held that MIPs created a fixed place PE of the Applicant in India.

b) The AAR observed that the activity of transmission of information between various banks in India and uploading of raw data and receipt of final data using application software are performed in India through Bank of India (the entity which carried out work for the Applicant, in relation to settlement, etc. in India) and therefore, the clearance and settlement of the transactions also happen in India.

The AAR principally observed, that even if significant activities are happening outside India; there can still be a PE in India, if significant activities are also happening in India. Relying on the earlier rulings in case of Amadeus Global Travel Distribution SA[3] and Galileo International Inc.[4], the AAR held that **the MasterCard Network** that consists of transmission tower, leased lines, fiber optic cable, nodes and internet, etc., also passed the tests of fixed place and permanency and creates a fixed place PE of the Applicant in India.

c) The AAR also observed that since the employees of Bank of India (BOI) carried out their functions in accordance with the instructions given by the Applicant, such employees were under the control and supervision of the Applicant, and hence the space occupied by them in the premises of BOI was effectively at the disposal of the Applicant. Hence, the AAR held that **Bank of India** also constituted a **fixed place PE** of the Applicant in India.

d) The AAR further observed that there were some functions and risk related to transaction processing which were earlier carried out by MasterCard International Incorporated (MCI or AE of the Applicant) in India and are still carried out by MISPL (as MISPL had taken over everything), but not shown in the functional, assets and risk analysis of MISPL. Hence, the AAR held that the **subsidiary company (MISPL)** also creates a **PE** of the Applicant in India.

e) The AAR further held that the services performed by visiting employees of MasterCard, such as taking customer feedback, providing information about new

3 Amadeus Global Travel Distribution SA vs. DCIT [2008] 113 TTJ 767 (ITAT Delhi)

4 Galileo International Inc. vs. DCIT [2008] 19 SOT 257 (Delhi)

products, and monitoring the efficiency of operations were an integral part of the transaction processing services provided by the MasterCard Asia Pacific to the Indian customers. The AAR stated that such services could not constitute stewardship activities. Accordingly, the AAR held that a **service PE** of the Applicant was constituted in India through such employees.

f) The AAR observed that MISPL habitually secured orders for the Applicant in India. The AAR also observed that all agreements entered into with Indian customers after the incorporation of MISPL were in fact routed through MISPL. According to AAR, this showed that MISPL was habitually securing orders for the Applicant, thereby resulting in the constitution of a **dependent agent PE** of the Applicant in India.

g) The AAR held that the licensing of various IPs in the form of brand/ trade name/ mark, etc. are not incidental to the activity of transaction processing and the payment made by various customer banks in India to the Applicant was also for the use of these IPs and hence, the same is royalty. The AAR also held that the same is effectively connected with various types of PEs, as discussed above. Thus, it would get taxed with the profits attributable to the PE under Article 7 of the DTAA and not under Article 12 of the DTAA.

The AAR also held that payments for the use of equipment (MIPs), or payments for use of a secret process (workings of the MIPs), or payments for use of software (application software of MasterCard Asia Pacific used for accessing the MasterCard network) would amount to royalty payments, but however, would be taxable as business profits under Article 7 for being effectively connected with a PE of the Applicant in India.

h) The AAR relied on the FAR of the Applicant and MISPL to conclude that the remuneration paid by the Applicant to MISPL was not at arm's length. Further, relying on the decision of the Hon'ble Supreme Court in Morgan Stanley[5], the AAR concluded that there would be a need to attribute further profits. On this basis, the AAR observed that the tax authorities may consider a further attribution of profits to MISPL.

C. Nokia Networks OY

Further, the Delhi ITAT SB in the case of Nokia Networks OY, deals with the issue of determination of a PE in India, when the non-resident carries out signing, networking, planning and negotiation of offshore supply contracts in India. It also debated the proposition set out by the revenue authorities as regards the concept of virtual projection.

1. Facts of the case:

Nokia Networks OY (Nokia Finland or the assessee) is a company incorporated under the laws of Finland and is engaged in the manufacturing of advanced telecommunication systems and equipment (GSM equipment) which are used in fixed and mobile phone networks; and trading of telecommunication of hardware and software.

The GSM equipment manufactured in Finland was sold to Indian telecommunication operators from outside India on a principal-to-principal basis under independent buyer-seller arrangements as well as certain contracts for installation were entered through the Liaison Office. Nokia Finland incorporated an Indian subsidiary, Nokia India Pvt. Ltd. (NIPL) in May 1995. The installation activities after such incorporation, were carried out by NIPL under its independent contracts with the Indian telecommunication operators.

The assessee claimed that there existed no business connection as well as no PE in India and hence, it was not liable to tax in India. The Assessing Officer (AO) however, did not agree and completed the

5 DIT(IT) vs. Morgan Stanley & Co. Inc (292 ITR 416) (SC)

assessment holding both the Liaison Office and NIPL as constituting a PE of the assessee. The AO relied heavily on the fact that the assessee had provided guarantee for the services rendered by NIPL to the customers of NIPL. The AO also relied on the fact that the contracts for offshore supply of equipment were signed in India.

2. Decision of the Delhi ITAT (SB) (majority view)

a) Fixed Place PE under Article 5(1) of the India-Finland DTAA (DTAA)

The ITAT stated that, for establishing a fixed place PE, as referred to in Article 5(1) of the DTAA, one of the crucial terms used is *'fixed place of business through which the business of an enterprise is wholly or partly carried on'*. The word 'through' assumes a great significance, because it enlarges the scope of a fixed place in as much as, where no fixed premises may belong to an enterprise but even if a particular space is made available at its disposal then such place is reckoned to be place of business under this paragraph.

The ITAT referred to the judgement of the Hon'ble Supreme Court (SC) in the case of Formula One[6], wherein it was held that the place of business will qualify, ***only if the place is at the disposal of the enterprise.*** The term ***'at the disposal'*** of the enterprise means when the enterprise has the right to use the said place and the control thereupon.

The ITAT noted that there was no evidence brought out on record to show that the premises of NIPL were at the disposal of the assessee. The ITAT observed that though administrative services namely telephone/ fax/ conveyance services were provided by NIPL, there was no place of business which was provided by NIPL 'at the disposal' of the assessee for carrying out its business wholly or partly in India. It was nowhere brought out by the AO that, any kind of physically located premise or a particular location was made available to the assessee.

The ITAT observed that providing telephone/ fax/ conveyance services could not be equated with fixed place and thus, concluded that providing such kind of administrative support services will not result in the determination of a fixed place PE.

The ITAT also observed that mere signing of the offshore supply contracts in India, planning and negotiation or networking before the actual supply of goods, are preliminary activities (i.e. preparatory and auxiliary) and therefore, would fall under the exclusion provided under Article 5(4) of the DTAA and thus would not constitute a PE of the assessee in India.

The ITAT specifically held that in case of offshore supply of goods, what is of importance is that the sale has taken place outside India and once this fact is established, the activities of negotiation, signing are preparatory and auxiliary in nature, thus such activities would not lead to the determination of a PE.

b) Agency PE under Article 5(5) of the DTAA

The tests to be satisfied For Dependent Agent PE (DAPE), as laid down by the ITAT are:

– Commercial activities of the agent for the enterprise are subject to instruction or comprehensive control

– The agent does not bear entrepreneurial risk

The ITAT noted that NIPL neither had any authority to conclude contracts for supply, nor any of the orders were booked by NIPL which were binding upon the assessee. The ITAT observed that managing or providing guarantee by assessee does not yield any income to the assessee, albeit to NIPL, which is already taxed in India.

c) Virtual Projection

The main argument of the AO was that the entire identity of the assessee and NIPL got blurred, and that NIPL was practically a ***'virtual projection'*** of the assessee in India and thus constituted PE relying

6 Formula One World Championship Ltd. vs. CIT [394 ITR 80 (SC)]

on the decision of Vishakhapatnam Port Trust[7], on the grounds that:

– NIPL carried out installation activities for the contract of supply entered by the assessee,

– NIPL carried out marketing and technical support services for the equipment installed by the assessee.

The ITAT held that the concept of virtual projection does not mean that even without a fixed place, virtual projection itself will lead to an inference of a PE. If on facts there is no establishment of a fixed place and disposal test is not satisfied, then virtual projection itself cannot be held to be a factor for creation of a PE. Thus, the ITAT held that the concept of virtual projection brought in by the AO would not lead to any kind of establishment of PE.

d) Business Connection

The ITAT observed that in the present case, the goods were manufactured outside India and even the sale had taken place outside India. Thus, the ITAT held that there existed no business connection of the assessee in India. The ITAT also relied on the decision of the Hon'ble High Court in the case of Nortel Network[8], wherein it was clearly concluded that equipments supplied overseas cannot be taxed under the Act.

D. Conclusion

Traditionally, the concept of a PE required some physical presence in the country seeking to impose tax. Today, however, technology is changing the way companies conduct business. It is no longer necessary to have a physical presence in a country in order to sell products or services in that country. Thus, the integral question is whether the mere use of computer equipment (e.g., a computer server, network, etc.) located in a country, fulfills the essential requirements for determination of a PE. In the days to come, this is going to be of critical importance to both governments and businesses.

The AAR ruling on MasterCard (*supra*) once again brings to fore the disconnect with the traditional understanding of the concept of a PE and trying to fit that understanding to the technological innovation of carrying on business in the source country, through revolutionary methods of information technology and communication via digital means.

Technological advancement by way of artificial intelligence, etc. will no longer require human intervention for interaction with the customer. This methodology of conducting business may lead to difficulty with the question in tax law, of determining whether a non-resident has a PE in the source country and the ability of the government to tax the profits in the source country.

Further, the decision of the ITAT Special Bench in the case of Nokia Networks OY (supra) brings out the important principle that for determination of a PE in India, as regards the transaction of sale of offshore equipment, what is important is where the sale of the offshore equipment takes place. If the supply of equipment is outside India, the transaction cannot be taxed in India.

Another important facet considered by the ITAT is the concept of 'virtual projection' as espoused in the judgment of Vishakhapatnam Port Trust (supra). The ITAT ruled that virtual projection should not be seen de hors the determination of a PE in India. Thus, the concept of virtual projection has to be seen alongwith the other facts of the case, which would determine whether the non-resident has a PE in India under the relevant DTAA.

The above judgements clearly brings out that the determination of a PE is a fact based exercise and thus regard should be given to the facts and circumstances of each case, before deciding the existence of a PE. Detailed documentation demonstrating the correct economic substance of the transactions, would help the taxpayers to mitigate the risk of PE exposure.

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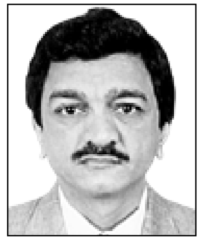
7 CIT vs. Vishakhapatnam Port Trust [(1983) 144 ITR 146 (SC)]

8 Nortel Network India International v. DIT [(2016) 386 ITR 353 (Del)]



B. V. Jhaveri, *Advocate*

DIRECT TAXES
Supreme Court

It is a fundamental rule of law of taxation that unless otherwise expressly provided, income cannot be taxed twice. A taxing Statute should not be interpreted in such a manner that in effect it will cast a burden for the payment of tax on the taxpayer doubly, unless the language of the Statute expressly states so and it is so compelling that the court has no alternative than to accept it. In a case of reasonable doubt, the construction most beneficial to the taxpayer is to be adopted

Mahaveer Kumar Jain vs. CIT – (2018) 255 Taxman 161 (SC)

1. In this case the appellant had income from business, house property and prize money received from the Sikkim State Lottery. Out of the gross prize money received by the appellant of ₹ 20,00,000, ₹ 2,00,000 were deducted as commission of agent/seller and ₹ 1,79,088 as income tax. The appellant in the return of income disclosed the income from lottery at gross amount of ₹ 20,00,000 and showed deduction of ₹ 2,00,000 as agent/seller commission. The appellant claimed deduction u/s. 80TT of the Act of ₹ 20,00,000.

2. In scrutiny assessment, the Assessing Officer allowed deduction u/s. 80TT of the Act on ₹ 18,00,000 after deduction of agent/seller's commission. The AO held that deduction u/s. 80TT can be claimed only on the net income from the lottery and not on gross income.

   On appeal, the CIT(A) confirmed the order of the Assessing Officer.

   On further appeal, the Tribunal allowed the appeal of the assessee partly, however, dismissed the objections of the assessee about the legality of assessment order and held that the lottery amount is taxable under the provisions of the Income-tax Act.

   At the instance of the assessee, the Tribunal framed the following questions for the High Court for its opinion:

   "1. Whether on the facts and on the circumstances of the case, the Hon'ble Tribunal was justified in holding that income from Sikkim State Lottery is taxable under the Income-tax Act, 1961?"

   "2. Whether in the facts and in the circumstances of the case the Tribunal was justified in holding that deduction u/s. 80TT is applicable on the net winning amount received by the assessee and not on gross amount of the winning prize?"

The Hon'ble High Court answered the questions in affirmative and in favour of the Revenue.

Being aggrieved with the decision of the High Court, the assessee was before the Supreme Court.

3. The Supreme Court while deciding the case considered the provisions of section 5 of the Income-tax Act. The Supreme Court also considered the peculiar facts pertaining to the case as the income was earned in the state of Sikkim, which was not part of India prior to 26th April, 1975. However, since the assessee was resident of the State of Rajasthan where the Income-tax Act was applicable, it was held that his global income was taxable even if the he had earned income in the state where Income-tax Act was not applicable. It was accordingly held:

"10. *The result, therefore, is that, while Section 5 of the IT Act would not be applicable, the existing Sikkim State Income-tax Rules, 1948 would be applicable. Thus, on the income, it would appear that Income-tax would be payable, under Sikkim State Income-tax Rules, 1948 and not under the IT Act. Since Sikkim is a part of India for the accounting year, there would appear to be, on the same income, two types of income taxes cannot be applied."*

The Supreme Court further considered the following decisions where it was held that unless otherwise expressly provided, income cannot be taxed twice:

i) *Laxmipat Singhania vs. Commissioner of Income-tax, U.P. (1969) 72 ITR 291 (SC)*
ii) *Jain Brothers and Others vs. Union of India and Others (1970) 77 ITR 107 (SC)*

Accordingly it was held:

"13. *The above referred cases make it clear that there is no prohibition as such on double taxation provided that the legislature contains a special provision in this regard. Now, the only question remains to be decided is whether in fact there is a specific provision for including the income earned from the Sikkim lottery ticket prior to 1-4-1990 and after 1975, in the income-tax return or not. We have gone through the relevant provisions but there seems to be no such provision in the IT Act wherein a specific provision has been made by the legislature for including such an income by an assessee from lottery ticket. In the absence of any such provision, the assessee in the present case cannot be subject to double taxation. Furthermore, a taxing Statute should not be interpreted in such a manner that its effect will be to cast a burden twice over for the payment of tax on the taxpayer unless the language of the Statute is so compelling that the court has no alternative than to accept it. In a case of reasonable doubt, the construction most beneficial to the taxpayer is to be adopted. So, it is clear enough that the income in the present case is taxable only under one law. By virtue of clause (k) to Article 371F of the Constitution which starts with a non-obstante clause, it would be clear that only the Sikkim Regulations on Income-tax would be applicable in the present case. Therefore, the income cannot be brought to tax any further by applying the rates of the IT Act."*

"14. *In view of the aforementioned discussions, <u>we are of the considered view that once the assessee has paid the income tax at source in the State of Sikkim as per the law applicable at the relevant time in Sikkim, the same income was not taxable under the IT Act, 1961. Having decided so, the other issue whether the income that is to be allowed deduction under section 80 TT of the IT Act is on 'Net Income' or 'Gross Income', becomes academic."</u>*

Loan Waiver - Applicability of S. 28(iv) & 41(1): (a) S. 28(iv) does not apply if the receipts are in the nature of cash or money, (b) S. 41(1) does not apply if the waiver of loan does not amount to cessation of trading liability, i.e., if the assessee has not claimed any deduction u/s. 36(1)(iii) of the IT Act *qua* the payment of interest in any previous year. Difference between trading liability and other liability highlighted

CIT vs. Mahindra and Mahindra Ltd. (2018) 255 Taxman 305 (SC)

1. The facts in the case were the Respondent company decided to expand its motor product line by including two new models. For this purpose, it entered into an agreement with Kaiser Jeep Corporation based in America wherein it was agreed to sell dies, welding equipments, die models to the Respondent. The final price of $ 6,50,000/- was agreed and the Respondent took all the requisite approvals in this regard. The tooling and other equipments were provided by the Kaiser Jeep Corporation for which the Kaiser Jeep Corporation agreed to provide the loan for a period of 10 years with interest at the rate of 6% p.a. repayable after 10 years. Thereafter, Kaiser Jeep Corporation was taken over by the American Motor Corporation, who agreed to waive the principal amount advanced to the Respondent by the Kaiser Jeep Corporation.

   In the assessment proceedings, the AO considered the waiver of loan amount as cessation liability and accordingly taxed the amount of loan u/s. 28 of the Act.

   On appeal, the CIT(A) dismissed the appeal and upheld the decision of the AO with certain modifications.

   On further appeals by the assessee-Respondent as well as the Revenue, the Tribunal set aside the order of the CIT(A) and decided the case in favour of the assessee-Respondent.

   Being aggrieved, the Revenue filed a reference before the High Court where the order was passed conforming the decision of the Tribunal in favour of the assessee-Respondent.

   Thereafter, the Revenue filed the appeals before the Supreme Court where the moot question to be answered was that whether waiver of loan amount by the lender would constitute taxable income u/s. 28(iv) or taxable u/s. 41(1) of the Act.

2. The Supreme Court considering the applicability of provisions of section 28(iv) held as under:

   "13) On a plain reading of Section 28(iv) of the IT Act, prima facie, it appears that for the applicability of the said provision, the income which can be taxed shall arise from the business or profession. Also, in order to invoke the provision of Section 28(iv) of the IT Act, the benefit which is received has to be in some other form rather than in the shape of money. In the present case, it is a matter of record that the amount of ₹ 57,74,064/- is having received as cash receipt due to the waiver of loan. Therefore, the very first condition of Section 28(iv) of the IT Act which says any benefit or perquisite arising from the business shall be in the form of benefit or perquisite other than in the shape of money, is not satisfied in the present case. Hence, in our view, in no circumstances, it can be said that the amount of ₹ 57,74,064/- can be taxed under the provisions of Section 28(iv) of the IT Act."

   The Apex Court further discussed the applicability of the Section 41(1) of the IT Act and held as under:

"15) *On a perusal of the said provision, it is evident that it is a sine qua non that there should be an allowance or deduction claimed by the assessee in any assessment for any year in respect of loss, expenditure or trading liability incurred by the assessee. Then, subsequently, during any previous year, if the creditor remits or waives any such liability, then the assessee is liable to pay tax under Section 41 of the IT Act. The objective behind this Section is simple. It is made to ensure that the assessee does not get away with a double benefit once by way of deduction and another by not being taxed on the benefit received by him in the later year with reference to deduction allowed earlier in case of remission of such liability.*

It is undisputed fact that the Respondent had been paying interest at 6% per annum to the KJC as per the contract but the assessee never claimed deduction for payment of interest under Section 36(1)(iii) of the IT Act. In the case at hand, learned CIT(A) relied upon Section 41(1) of the IT Act and held that the Respondent had received amortisation benefit. Amortisation is an accounting term that refers to the process of allocating the cost of an asset over a period of time, hence, it is nothing else than depreciation. Depreciation is a reduction in the value of an asset over time, in particular, to wear and tear. Therefore, the deduction claimed by the Respondent in previous assessment years was due to the depreciation of the machine and not on the interest paid by it."

"16) *Moreover, the purchase effected from the Kaiser Jeep Corporation is in respect of plant, machinery and tooling equipments which are capital assets of the Respondent. It is important to note that the said purchase amount had not been debited to the trading account or to the profit or loss account in any of the assessment years. Here, we deem it proper to mention that there is difference between 'trading liability' and 'other liability'. Section 41(1) of the IT Act particularly deals with the remission of trading liability. Whereas in the instant case, waiver of loan amounts to cessation of liability other than trading liability. Hence, we find no force in the argument of the Revenue that the case of the Respondent would fall under Section 41(1) of the IT Act."*

"17) *To sum up, we are not inclined to interfere with the judgment and order passed by the High Court in view of the following reasons:*

(a) *Section 28(iv) of the IT Act does not apply on the present case since the receipts of ₹ 57,74,064/- are in the nature of cash or money.*

(b) *Section 41(1) of the IT Act does not apply since waiver of loan does not amount to cessation of trading liability. It is a matter of record that the Respondent has not claimed any deduction under Section 36(1)(iii) of the IT Act qua the payment of interest in any previous year."*

Accordingly the appeals of the Revenue were dismissed.

Severe strictures passed by the Supreme Court against the Union of India for non-implementation of The National Litigation Policy and for pursuing vexatious litigation

Union of India and Others vs. Prithwi Singh & Others, IA Nos. 52056 to 52059 of 2018, dated 24th April, 2018.

1. In this case the Supreme Court has passed strictures on the Union of India with regard to the state of litigation in India

and particularly in the Supreme Court. In this case, the Union of India had filed a batch of appeals which was dismissed by the Supreme Court by order dated 8th December, 2017 in the case of *Union of India vs. Balbir Singh Turn*. After dismissal of the batch of appeals, the Union of India filed another appeal on same subject in civil appeal filed in 2018 in *Union of India vs. Ex. Nk. Balbir Singh* which came before the Court for consideration on 9th March, 2018 and was dismissed following the decision in Balbir Singh Turn. While dismissing the appeal, it was noted that it was filed after several similar matters were dismissed by the Apex Court. To ensure that the Union of India shape-up litigation policy, cost of ₹ 1,00,000/- was imposed and the Supreme Court remarked:

"6. To ensure that the Union of India is far more circumspect, costs of ₹ 1,00,000/- were imposed and it was observed that the Union of India must shape up its litigation policy. Unfortunately, the Union of India has learnt no lesson and has continued its non-cooperative attitude."

"8. The Union of India must appreciate that by pursuing frivolous or infructuous cases, it is adding to the burden of this Court and collaterally harming other litigants by delaying hearing of their cases through the sheer volume of numbers. If the Union of India cares little for the justice delivery system, it should at least display some concern for litigants, many of whom have to spend a small fortune in litigating in the Supreme Court."

Thereafter the Supreme Court also considered The National Litigation Policy and also explored the meaning of the words 'efficient litigant' and 'responsible litigant' as also other policies framed thereunder. The Supreme Court further held:

"10. None of the pious platitudes in the National Litigation Policy have been followed indicating not only the Union of India's lack of concern for the justice delivery system but scant regard for its own National Litigation Policy."

"11. The website of the Department of Justice shows that the National Litigation Policy, 2010 is being reviewed and formulation of the National Litigation Policy, 2015 is under consideration. When this will be finalised is anybody's guess. There is also an Action Plan to reduce Government Litigation which was formulated on 13th June, 2017."

"12. Nothing has been finalised by the Union of India for the last almost about 8 years and under the garb of ease of doing business, the judiciary is being asked to reform. The boot is really on the other leg."

"13. Interestingly, the Action Plan mentions, among others, two interesting steps to reduce pendency:

(i) Avoid unnecessary filing of appeals – appeals should not be filed in routine matters – only in cases where there is a substantial policy matter.

(ii) Vexatious litigation should be immediately withdrawn."

"14. These pendency reduction steps (particularly (ii) above) have been conveniently overlooked as far as this appeal is concerned."

"15. To make matters worse, in this appeal, the Union of India has engaged 10 lawyers, including an Additional Solicitor General and a Senior Advocate! This is as per the appearance slip submitted to the Registry of this Court. In other words, the Union of India has created a huge financial

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liability by engaging so many lawyers for an appeal whose fate can be easily imagined on the basis of existing orders of dismissal in similar cases. Yet the Union of India is increasing its liability and asking the taxpayers to bear an avoidable financial burden for the misadventure.

Is any thought being given to this?"

"16. The real question is: When will the Rip Van Winkleism stop and Union of India wake up to its duties and responsibilities to the justice delivery system?"

"17. To say the least, this is an extremely unfortunate situation of unnecessary and avoidable burdening of this Court through frivolous litigation which calls for yet another reminder through the imposition of costs on the Union of India while dismissing this appeal. We hope that someday some sense, if not better sense, will prevail on the Union of India with regard to the formulation of a realistic and meaningful National Litigation Policy and what it calls 'ease of doing business', which can, if faithfully implemented benefit litigants across the country."

S. 10A: Deduction of expenses for the computation of 'Total Turnover' is allowed u/s. 10A of the IT Act because on the contrary, non-allowability would give rise to inadvertent, unlawful, meaningless and illogical result and which would cause grave injustice to the assessee which could have never been the intention of the legislature. As the object of the formula is to arrive at the profit from export business, expenses excluded from export turnover have to be excluded from total turnover. Any interpretation that makes the formula unworkable and absurd should be discarded

CIT vs. HCL Technologies Ltd., Civil Appeal Nos. 8489-8490 of 2013, dated 24th April, 2018

1. The respondent company was registered under the Companies Act, 1956 and was engaged in the business of development and export of computer software and rendering technical services.

2. During the AY 2004-05, the Respondent company had shown gross income from business while claiming deduction u/s. 10A of the Act and thereby showing a net loss in the return of income. The Respondent company filed the return of income declaring undisclosed income. Thereafter revised return of income was also filed. The case was selected for scrutiny and the Assessing Officer held that the software development charges as claimed by the Respondent company are nothing but technical services provided outside India. Further in view of the fact that it was not purely technical service and some element of software development is also involved and in the absence of such bifurcation, the AO estimated such expenses at 40% and remaining 60% for providing technical services in foreign exchanges to its offshore clients.

On appeal, the CIT(A) partly allowed the appeal and estimated the software development charges at 10% instead of 60% estimated by the AO.

Being aggrieved, the Respondent company as well as the revenue filed cross appeals before the Tribunal. The Tribunal dismissed the appeal filed by the Revenue while allowing the appeal of the Respondent company.

The appeal of the Revenue before the High Court against the order of the Tribunal was dismissed.

Being aggrieved, the Revenue was before the Supreme Court raising the following question:

> *"Whether in the facts of the case the software development charges were to be excluded while working out the deduction admissible u/s. 10A of the Act on the ground that such charges were relatable towards expenses incurred on providing technical services outside India?"*

The Respondent contended that the definition of the 'total turnover' given under Sections 80HHC and 80HHE can be adopted for the purpose of Section 10A. Various judicial decisions pertaining to Section 80HHC were cited by the Respondent.

3. Considering the rival submissions, the Apex Court held as under:

"14) *In the above backdrop, we are of the opinion that the definition of total turnover given under Sections 80HHC and 80HHE cannot be adopted for the purpose of Section 10A as the technical meaning of total turnover, which does not envisage the reduction of any expenses from the total amount, is to be taken into consideration for computing the deduction under Section 10A. When the meaning is clear, there is no necessity of importing the meaning of total turnover from the other provisions. If a term is defined under Section 2 of the IT Act, then the definition would be applicable to all the provisions wherein the same term appears. As the term 'total turnover' has been defined in the Explanation to Section 80HHC and 80HHE, wherein it has been clearly stated that "for the purposes of this Section only", it would be applicable only for the purposes of that Sections and not for the purpose of Section 10A. If denominator includes certain amount of certain type which numerator does not include, the formula would render undesirable results."*

The Supreme Court held that rule of harmonious construction is the thumb rule to interpret any statute and the interpretation which makes the enactment consistent whole should be adopted and that should be the aim of the Courts. In this regard the decision of *Commissioner of Income Tax vs. J. H. Gotla, (1985) 23 Taxman 14J (SC)* was referred to.

The Apex Court also discussed the decision of the Karnataka High Court in the case of *CIT vs. Tata Elxsi Ltd. (2012) 204 Taxman 321/17* where the issue was similar to the question before the Apex Court. Consequently, it was held:

"19) *In the instant case, if the deductions on freight, telecommunication and insurance attributable to the delivery of computer software under Section 10A of the IT Act are allowed only in export turnover but not from the Total Turnover then, it would give rise to inadvertent, unlawful, meaningless and illogical result which would cause grave injustice to the Respondent which could have never been the intention of the legislature."*

"20) *Even in common parlance, when the object of the formula is to arrive at the profit from export business, expenses excluded from export turnover have to be excluded from total turnover also. Otherwise, any other interpretation makes the formula unworkable and absurd. Hence, we are satisfied that such deduction shall be allowed from the total turnover in same proportion as well."*

"21) *On the issue of expenses on technical services provided outside, we have to follow the same principle of interpretation as followed in the case of expenses of freight, telecommunication etc., otherwise the formula of calculation would be futile. Hence, in the same way, expenses incurred in foreign exchange for* *providing the technical services outside shall be allowed to exclude from the total turnover."*

Whether the amount received by an employee from redemption of Stock Appreciation Rights (SARs) can be assessed as "perquisite" u/s. 17(2)(iii) or as "profits of business" u/s. 28(iv) or as "capital gains" (despite no "cost of acquisition") u/s. 45 explained. CBDT Circular No. 710 dated 24-7-1995 also considered

ACIT vs. Bharat V. Patel, Civil Appeal No. 4380 of 2018 dated 24th April, 2018

1. Brief facts in the case are that the respondent was the Chairman and Managing Director of Proctor and Gamble (P&G), India, filed his return of income for the Assessment Year 1998-99. Thereafter, the A. O. made addition in the hands of the respondent on the ground that the amount received on redemption of Stock Appreciation Rights (SARs) from the P&G, USA was to be treated as capital gains and not as perquisites u/s. 17(2)(iii) of the Act and accordingly the A. O. completed the assessment u/s. 143(3) of the Act.

On appeal, the CIT(A) dismissed the appeal while comprehensively discussing the taxability of the alleged amount.

Being dissatisfied, the assessee-respondent appealed before the Tribunal and the appeal was partially allowed. The Tribunal in the order held that the stock options are capital assets and such assets in the instant case were acquired for consideration, hence gain arising therefrom was liable to capital gains tax.

The assessee as well as the Revenue filed the cross appeals before the High Court of Gujarat.

Simultaneously, the AO passed the order to give effect to the said order passed by the Tribunal. The AO held that the amount paid to the respondent by the P&G, USA shall be treated as capital gains on transfer or redemption of shares. On appeal against this order, the CIT(A) held the decision in favour of the AO. On further appeal, the Tribunal dismissed the appeal of the assessee-respondent, which was not further challenged.

With regard to the cross appeals, the High Court allowed the appeal filed by the assessee-respondent while dismissed the appeal filed by the Revenue. The High Court upheld the decision of the Tribunal, however, disagreed that such capital gains arose to the assessee-respondent since there was no cost of acquisition involved by the assessee-Respondent.

2. On further appeal, the Apex Court considered the amendment brought into the section 17 to bring the perquisite transferred by the employer to the employee within the ambit of the tax into the legislation and held as under:

> *"13) The intention behind the said amendment brought by the legislature was to bring the benefits transferred by the employer to the employees as in the instant case, within the ambit of the Income-tax Act, 1961. It was the first time when the legislature specified the meaning of the cost for acquiring specific securities. Only by this amendment, legislature determined what would constitute the specific securities. By this amendment, legislature clearly covered the direct or indirect transfer of specified securities from the employer to the employees during or after the employment. On a perusal of the said clause, it is evident that the case of the Respondent falls under such clause. However, since the transaction in the instant case pertains prior to 1-4-2000, hence, such transaction cannot be covered under the said clause in the absence of an express provision of retrospective effect. We also do not find any force in the argument of the Revenue that the case of the Respondent would fall under the ambit of Section 17(2) (iii) of the IT Act instead of Section 17(2) (iiia) of the IT Act.* ***It is a fundamental principle of law that a receipt under the IT Act must be made taxable before it can be treated as income. Courts cannot construe the law***

in such a way that brings an individual within the ambit of Income-tax Act to pay tax who otherwise is not liable to pay. In the absence of any such specific provision, if an individual is subjected to pay tax, it would amount to the violation of his Constitutional Right."

The Apex Court further referred to its decision in the case of **Infosys Technologies Ltd. [(2008) 297 ITR 167]** wherein the Apex Court held as under:

> *"17. Be that as it may, proceeding on the basis that there was "benefit" the question is whether every benefit received by the person is taxable as income? In our view, it is not so. Unless the benefit is made taxable, it cannot be regarded as income. During the relevant assessment years, there was no provision in law which made such benefit taxable as income. Further, as stated, the benefit was prospective. Unless a benefit is in the nature of income or specifically included by the legislature as part of income, the same is not taxable. In this case, the shares could not be obtained by the employees till the lock-in period was over. On facts, we hold that in the absence of legislative mandate a potential benefit could not be considered as "income" of the employee(s) chargeable under the head "salaries"….. ."*

The Supreme Court also observed that the contention of the Revenue that the amendment brought in by Section 17(2) of the IT Act was clarificatory, hence, retrospective in nature, was (can we write "rightly") dismissed by the High Court on the ground that as held in the case of B. C. Srinivas Setty [(1981) 128 ITR 294 (SC)] that the amendment brought into the statute cannot be read retrospectively unless expressly provided by the Legislature.

The Apex Court further considered the Circular No. 710 dated 24th July, 1995 issued by the CBDT and held as under:

> *"16. …..*
>
> *On a perusal of the above, prima facie, it appears that such Circular dealt with the cases where the employer issued shares to the employees at less than the market price. In the instant case, the Respondent was allotted Stock Appreciation Rights (SARs.) by the (P&G) USA which is different from the allotment of shares. Hence, in our opinion such Circular has no applicability on the instant case. Moreover, a Circular cannot be used to introduce a new tax provision in a Statute which was otherwise absent."*

Alternative plea of the Revenue that the case of the assessee-Respondent comes within the ambit of the Section 28(iv) of the IT Act was also rejected by the Apex Court as under:

> *"17. …..*
>
> *On a first look of the said provision, it is apparent that such benefit or perquisite shall have arisen from the business activities or profession whereas in the instant case there is nothing as such. The applicability of Section 28(iv) is confined only to the case where there is any business or profession related transaction involved. Hence, the instant case cannot be covered under Section 28(iv) of the IT Act for the purpose of tax liability."*

Thereafter, the Supreme Court concluded as under:

> *"18. To sum up, the Respondent got the Stock Appreciation Rights (SARs) and, eventually received an amount on account of its redemption prior to 1-4-2000 on which the amendment of Finance Act, 1999 (27 of 1999) came into force. In the absence of any express statutory provision regarding the applicability of such amendment from retrospective effect, we do not find any force in the argument of the Revenue that such amendment came into force retrospectively. It is well-established rule of interpretation that taxing provisions shall be construed strictly so that no person who is otherwise not liable to pay tax, be made liable to pay tax."*

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Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES
High Court

1. Business Expenditure u/s. 37 of the Income-tax Act, 1961 – Finding that commission payment was genuine and for the business – High Court cannot set aside finding of fact unless it is perverse – Perversity explained [A.Ys. 1994-95, 1996-97 & 1997-98]

CIT vs. Hind Nihon Proteins P. Ltd [2018] 404 ITR 193 (Delhi)

The assessee was a Private Limited Company. It entered into agreements with two partnership firms in which the parties related to the directors were partners. The assessee company paid commission to the partnership firms on the basis of sales. The AO while finalising the assessment disallowed commission payment on the ground that commission was paid to firms related to directors only to avoid tax or divert income. Being aggrieved by the assessment order, assessee preferred an appeal before the first appellate authority. The learned CIT(A), however, affirmed the addition made by the AO. On further appeal, the Tribunal deleted the addition by observing that the assessee had been paying commission to the Agents regularly year after year and it was not doubted by the revenue. It observed that the receipt of the commission was duly shown by those partnership firms in their balance sheets and profits and loss accounts and that they had paid the tax thereon. Further assessee had filed confirmations and statements of accounts to prove genuineness of payment of commission. Once the revenue has accepted receipt of commission in the hands of the recipient, it cannot raise dispute with regard to such payments, as they are not allowed to blow hot and cold in the same breath. The Tribunal also observed that the firms were also paying taxes at maximum marginal rate and thus the allegation that commission was paid to avoid tax or divert income was baseless. The department being aggrieved preferred an appeal before the Hon'ble Delhi High Court, which was dismissed. The Court held that the reasoning given by the ITAT and the factual matrix being contrary to the reasoning given by the AO and the CIT(A), the impugned order cannot be treated as perverse. While considering the question of perversity of a finding of fact, the test applicable is rather strict. The finding should be such which is arrived at without any material, or upon a view of the facts which could not reasonably be entertained or the facts found are such that no person acting judicially and properly instructed as to the relevant law would have come to that determination. Since this test and benchmark is to be satisfied and it was not possible to hold so in the present case and interfere. The High Court thus confirmed the Tribunal order.

2. Reassessment – Section 147 of the Income-tax Act, 1961 – notice under section 148 issued merely on the basis of information received from investigation wing without verifying the said information – Notice issued under section 148 is without jurisdiction [A.Y. 2003-04]

Pr. CIT vs. SNG Developers Ltd. [2018] 404 ITR 312 (Delhi)

The AO issued notice under section 148 of the Act on the basis of information received from the Directorate of Income-tax (Investigation) that the assessee company had received accommodation entries from certain persons who were not doing any business but were engaged in the activity of providing accommodation entries to other concerns, issuing cheques in lieu of cash received, after deducting their commission, and such cheques were issued as share application money or unsecured loans. The assessee filed detailed objections against the said reasons. However, the AO rejected the objections raised by the assessee and finalised the assessment by treating the transaction of the assessee as not genuine. The assessee being aggrieved by the above assessment order preferred an appeal before the first appellate authority. The Ld. CIT(A) allowed the appeal of the assessee and quashed the reassessment proceedings by observing that the reopening of the assessment was without any satisfaction, without verifying the information received from the Investigation Wing, the AO has not applied his mind on the information received and there was no satisfaction on the part of the AO regarding the escapement of income. The department being aggrieved by the order of the Ld. CIT(A) preferred an appeal before the Appellate Tribunal. The Tribunal upheld the order of the Ld. CIT(A) and dismissed the appeal. The department carried the matter further in appeal before the Hon'ble Delhi High Court. The Court relied on *PCIT vs. Meenakshi Overseas Ltd. (2017) 395 ITR 677 (Del)* wherein it was held that the crucial link between the information made available to the Assessing Officer and the formation of belief is absent. The reasons must be self evident, they must speak for themselves. The tangible material which forms the basis for the belief that income has escaped assessment must be evident from a reading of the reasons. The entire material need not be set out. However, something therein which is critical to the formation of the belief must be referred to. Otherwise the link goes missing. The reopening of assessment under section 147 is a potent power not to be lightly exercised. It certainly cannot be invoked casually or mechanically. The heart of the provision is the formation of belief by the Assessing Officer that income has escaped assessment. The reasons so recorded have to be based on some tangible material and that should be evident from reading the reasons. It cannot be supplied subsequently either during the proceedings when objections to the reopening are considered or even during the assessment proceedings that follow. This is the bare minimum mandatory requirement of the first part of section 147(1) of the Act. Hon'ble High Court thus dismissed the appeal observing that the reasons recorded by the AO for reopening the assessment under section 147 did not meet the statutory conditions and there was non-application of mind on the part of the A.O.

3. Penalty u/s. 271(1)(c) of the Income-tax Act, 1961 – Exemption under section 10(38) claimed on Capital Gains without setting off the losses – *bona fide* belief that loss not required to be considered under section 10(38) – Penalty not sustainable on the said disallowance. (A.Y. 2008-09)

DIT (IT) vs. Nomura India Investment Fund Mother Fund [2018] 404 ITR 636 (Bom)

The assessee was an approved sub-account of the Master Trust Bank of Japan, a foreign institutional investor, registered with Securities and Exchange Board of India. During the year under consideration, the assessee has earned long-term capital gains as well as long-term capital loss on purchase and sale of shares. While computing the capital gains the assessee did not set off the long-term capital loss from long-term capital gains which were claimed as exempt under section 10(38) of the Act. The assessee in the return of income put a note that it reserved its rights to carry forward the long-term capital loss. The AO while finalising the assessment rejected the claim of the assessee and also levied penalty under section 271(1)(c) of the Act on the said disallowance. The assessee being aggrieved by the order of penalty filed an appeal before the first appellate authority. The learned CIT(A), however, upheld the view of the AO and dismissed the appeal. On further appeal the Appellate Tribunal allowed the appeal of the assessee and deleted the penalty levied by the AO. The Department filed an appeal before Bombay High Court. Hon'ble High Court dismissed the appeal of the revenue by observing that the provisions of section 271(1)(c) could only be invoked upon satisfaction of the conditions laid down therein. The assessee had claimed exemption under section 10(38) with a note that it reserved its right to carry forward the long-term capital loss, under the *bona fide* belief that under section 10(38) the loss was not required to be considered. It could not be stated that the act of the assessee in giving the note was with some ulterior intention or concealment of income or giving inaccurate particulars. Therefore, penalty was rightly cancelled by the Tribunal.

4. Expenditure u/s. 37 – Expenses incurred for further studies of one of the director's son – Not incurred wholly and exclusively for the purposes of business – disallowance confirmed (A.Y. 1997-98)

Indian Galvanics Cyrium Foils Ltd. vs. DCIT, ITA 199 of 2002, order dated 6th July, 2018

The appellant-assessee was a closely held industrial company engaged in manufacturing copper foils. During the previous year ending on 31-3-1997, the appellant-assessee incurred expenditure of ₹ 11,76,540/- under the head 'Management Training and Development expenditure'. It was incurred for higher education and training of Shri Harsh Kumar who had been sent to USA for course in "Business Administration". Shri Harsh Kumar was son of one of the directors, Shri Arun Kumar Dalmia. In the course of the assessment, it was explained that expenditure was incurred for the purpose of assessee's business, so as to ensure better administration in long run. That, as such assessee thought it fit to train suitable employee. The assessee contended that an agreement was executed by the concerned employee, who then had committed to serve assessee for ten years. It was brought to notice of the Income-tax Officer that after completing education and training, Shri Harsh Kumar was serving assessee for three years. It is on this premise it was claimed that expenditure then incurred on his education and training was incurred wholly and exclusively for the purpose of business. Though the claim was rejected by the Assessing Officer, the CIT(A) allowed the appeal. The Tribunal reversed the CIT(A) order and confirmed the disallowance. On appeal, the High Court observed that, assessee was a company manufacturing copper foils, whereas the son of one of the directors was sent to USA for completing course in Business Administration which was 'general' in nature and had no direct nexus with the business activities of the assessee. Assessee did not place better particulars on record like, basic qualification of Mr. Harsh Kumar; subjects in which he did his administration course; how such subjects had nexus to business activities of Assessee and so on. Though a contract was placed on record whereby Mr. Harsh Kumar had agreed to render his services after completing his education and training, but that itself was not sufficient to hold that the assessee has proved nexus between the expenditure and its business activities. The High Court distinguished the decision in case of *Sakal Papers Pvt. Ltd. vs. CIT, Poona 1977 SCC Online Bom 199*. The High Court dismissing the appeal concluded that amount claimed was not incurred wholly and exclusively for the purpose of business of the assessee.

5. Appeal to High Court u/s. 260A – Substantial question of law – Transfer Pricing cases relating

The assessee was engaged in providing software services to its associated enterprise (AE). During the assessment year i.e. 2006-07, it earned an operating profit of 8.33% on cost. The assessee applied Comparable Uncontrolled Price (CUP) method for substantiating arm's length price (ALP) of its international transactions which was rejected by the Transfer Pricing officer (TPO). The TPO applied transactional net margin method (TNMM) using a set of 20 comparables. He thus determined ALP at cost plus which after giving effect to working capital adjustment was at 18.86%. On appeal, the CIT(A) applied related party transaction (RPT) filter and turnover filter, and analysed other comparables having abnormal margin. The CIT(A) thus rejected all except three comparables as selected by the TPO. Both the assessee and the revenue filed an appeal before Appellate Tribunal. The Tribunal after detailed analysis rejected the comparables selected by the CIT(A) and instead included some comparables of the TPO, after applying RPT filter of 15% and other functional comparability criteria. The Revenue in an appeal before the HC raised two questions; one on rejection of certain comparables and, second on RPT filter being 15%. The Karnataka High Court noted that the entire exercise of making a TP adjustment on the basis of comparable is nothing but a matter of estimate of a broad and fair guess work of the authorities based on relevant material before them. Such an exercise is undertaken by the expert/specialised wing of the Income Tax Department ('department') manned by the Transfer Pricing Officer ('TPO') and the higher level by a Collegium of three Commissioners in the form of Dispute Resolution Panel ('DRP'), whose orders being questions of facts are appealable before the highest fact finding body, viz., the Tribunal. The High Court held that certain issues like discussion on comparability of individual companies, application of filter and other factors in relation to ALP determination, are essentially a fact finding exercise and cannot be entertained by the High Court. If appeals under Sec 260-A of the Act were to be lightly entertained by High Court against the findings of the Tribunal, without putting it to a strict scrutiny of the existence of the substantial questions of law, it is likely to open the flood-gates for such litigations to spill over on the dockets of the High Courts and up to the Supreme Court, which may cause further delay and serious damage to the demand of expeditious judicial dispensation. Section 260A(6) does not give any extended power-disturb the findings of the fact given by the Tribunal. High Court also compared the provisions of Section 260-A with those of Section 100 and 103 of the Code of Civil Procedure. It concluded that what could be substantial question of law could be interpreted from settled jurisprudence on this issue covered by various Supreme Court decisions. Some principles that emerge from various landmark rulings explaining substantial question of law include following instances:

– Whether it is of general public importance
– Whether it directly and substantially affect the rights of the parties
– Whether the court can frame additional questions of law
– Misconstruction of documents or wrong application of law to construe a document
– Whether it has a material bearing
– If the court below has acted in contrary to an already settled position
– Whether the court below has ignore material evidence or acted on non evidence
– Wrong application of law
– Lower courts or Tribunal have wrongly cast burden of proof
– If the order has been passed ex-parte
– Whether the findings of the Tribunal are perverse in nature

The HC held that if it were to take the path of undertaking comparative analysis and work on the filters, it would drag itself into a data analysis work, which would defeat the purpose of section 260A of the Act. The appeal in such cases can be made to the High Court only if there is any perversity in the findings of the Tribunal. The HC held that in the present case the department has neither appealed nor there was any perversity in the order of the Tribunal. Hence the departmental appeal was dismissed.

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Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES
Tribunal

Reported Decisions

1. Business Expenditure – Custom duty paid to the Government by way of reimbursement through an agent does not warrant any deduction of tax at source u/s. 194C of the Act and no disallowance can be made u/s. 40(a)(ia) of the Act

Lion Mercantile Pvt. Ltd. vs. ITO, ITA No.5998/Mum/2014, dt.27/06/2018 AY 2010-11 (Mum.)(Trib.)

Facts

The assessee is a private limited company and the assessment year under consideration is 2010-11. During the course of assessment proceedings, the Ld. AO observed that the assessee had reimbursed the custom duty paid by it to its custom housing agent (CHA) to the Government on behalf of the assessee. The AO concluded that the same is subject matter of deduction u/s. 194C of the Act and subsequently, disallowed the said business expenditure u/s. 40(a)(ia) of the Act. Aggrieved with the order of the assessment order, an appeal was preferred before the Ld. CIT(A). The CIT(A) confirmed the view of the Ld. A.O. Thereafter, the Assessee preferred an appeal before Hon'ble ITAT which held as under:

Held

Hon'ble ITAT observed that a separate debit note was issued by the said "CHA" to the assessee with regard to reimbursement of custom duty which was paid by the Assessee to "CHA" without deduction of any tax being a reimbursement. Hon'ble ITAT concluded that payment of custom duty to the Government on import of goods even if paid through "CHA" agent by way of reimbursement would not warrant a deduction of tax at source u/s. 194C of the Act and the expenditure is required to be allowed within the provisions of Act. Hon'ble ITAT allowed the contention of the Assessee and reversed the action of the Ld. CIT(A) and the AO by allowing the said custom duty to the Assessee as a business expenditure. The issue was decided in favour of the Assessee and against the revenue.

2. Business Expenditure – Section 37(1) of the Act – genuineness is not doubted – Commercial Expediency – A.O. not to step into the shoes of the assessee

Dyes Sales (India) vs. Income Tax Officer – 13(3)(3), Mumbai (ITA 5453/Mum/2016) [Assessment Year: 2010-11] order dated 26-4-2018

Facts

The assessee is a partnership firm and carrying the business as a reseller in Dying and Chemicals. The assessee filed its return on 7-8-2010 declaring the total income at ₹ 18,58,540/-. The return was selected for scrutiny assessment to verify the genuineness of the claim of expenses under the head repairs and maintenance amounting to ₹ 14,14,862/- under section 37(1) of the Act. During the course of assessment proceedings, the assessee furnished the sample copies of invoices, debit notes, tax invoices and copy of the ledger accounts of Rangoli Gases from whom the assessee purchased the gas. After perusing the details, the Ld.A.O. observed that the assessee had paid handling charges to M/s. Rangoli Gas only and no other supplier had charged such kind of expenses. Thus, the Ld.A.O. reached the conclusion that the expenses claimed by the assessee were inflated and excessive in nature. Therefore, the Ld. A.O. made disallowance of ₹ 14,14,862/- under section 37(1) of the Act. On the appeal, the Ld. CIT(A) dismissed the appeal of the assessee by observing that the genuineness of the expenses had not been in dispute, but the relevance and purpose in terms of section 37(1) was not proved as to whether the said expenses were 'wholly and exclusively' for the purposes of the business. The assessee being aggrieved by the order passed by the Ld. CIT(A) preferred an appeal before Hon'ble ITAT. During the course of hearing before Hon'ble ITAT both the parties put their contentions. After hearing the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT after considering the facts of the case and material on record observed that the assessee had already placed on record the copy of annual accounts along with copy of the ledger account of M/s. Rangoli Gases, copy of confirmation of accounts, copy of month wise details along with debit notes etc. Hon'ble ITAT, further, observed that since the genuineness of the expenses were not in dispute by the Ld. CIT(A), the only question for the consideration is whether the handling charges incurred by the assessee were 'wholly and exclusively for the purpose of business or there was any commercial expediency. Further, Hon'ble ITAT observed that while applying the test of 'commercial expediency' for determining whether the expenditure was wholly and exclusively laid out for the purpose of business, the reasonableness of the expenditure must be adjudged from the point of view of the businessman and not of the revenue. After perusing the documents placed in the paper book, Hon'ble ITAT observed that the expenses incurred by the appellant were incurred wholly and exclusively for the purpose of business only. Hon'ble ITAT while coming to this conclusion relied on the decision of the Hon'ble Supreme Court in the case of *CIT vs. Walchand & Co. Pvt. Ltd. [1967] 65 ITR 381 (SC)* and allowed the appeal filed by the appellant.

3. Exemption: Activity of the society to take care of health of people, comes within the ambit of advancement of any other object of general public utility and it is eligible for exemption u/s. 11 of the Act

Institute of Health Systems vs. ITO, ITA No.1783/Hyd/2017 dated 28-6-2018, AY 2014-15 (Hyd.)(Trib.)

Facts

The assessee is a society formed with effect from 5th December, 1990 and registered u/s. 12A on 19-12-1990. The Assessment year under consideration is 2014-15. The memorandum of society defines "Health Systems" which includes the professional, technological, behavioural, social, economic, cultural and other sub-systems whose interrelated action contribute to the health of the people. The assessee filed its return of income under consideration by declaring "NIL" income by claiming exemption u/s. 11. The return filed by the assessee was processed u/s. 143(1) of the Act and thereafter, the assessment was completed u/s. 143(3) of the Act. While completing the assessment, the Ld. AO denied the exemption u/s. 11 as claimed by the assessee by observing that during the year under consideration, the assessee provided services to Hyderabad Metro Water Supply and Sewerage Board (HMWSSB) towards water quality testing and incurred expenditure with reference to the services provided by it. According to the Ld. AO, the assessee has not incurred any expenditure relating to charitable activity for the cause of education, medical aid or relief to poor and even not incurred any expenditure for the general public utility. Further he observed that the activity of the assessee is professional/technical services not in accordance with the aim and object of the society and the activity carried out by the assessee is not for charitable purposes. The Ld. AO at the end denied the benefit of exemption u/s. 11 of the Act since the assessee received the revenue receipts from services rendered to HMWSSB which as per the conclusion of the Ld. AO was principally commercial in nature. Aggrieved with the said assessment order, the assessee preferred an appeal before the Ld CIT(A) without finding any success. Thereafter, the appeal was preferred before Hon'ble ITAT. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that the assessee's activity comes within the purview of exceptions provided under sub-section (15) of sub-clause (i) for the reason that the activity of the assessee is testing of the water quality, which monitors quality in reservoirs and slum areas, for that, assessee has charged some fee and almost the entire fee was spent towards testing activity. Testing of water and thereby supplying good quality of water contribute to health of the people. Therefore, Hon'ble ITAT categorically held that the activity of the assessee is not commercial in nature and the assessee is entitled to claim the exemption u/s. 11 of the Act. In view of the aforesaid observations, Hon'ble ITAT allowed the appeal filed by the assessee.

4. Income from business and profession – Section 28(i) of the Act – no addition can be made when an explanation offered for charging a lower price in respect of building sold by the assessees is not controverted by the Ld. A.O.

M/s. Shah Realtors vs. ACIT Circle – 4 (ITA 2656/Mum/2016) [Assessment year: 2012-13], order dated 25-5-2018

Facts

The assesse is a partnership firm and engaged in the business of real estate. During the year under consideration the assesse sold various buildings in the industrial park. During the course of scrutiny assessment, the Ld. A.O. observed that there was a variation in the rate of properties in two buildings sold, ranging between ₹ 1948/- per sq.ft for building no.10. and ₹ 5025/- per sq.ft. for building no.3. The Ld. A.O. issued a notice under section 133(6) of the Act to the buyers of building No.3. In response to the said notice, the buyer filed its reply and confirmed the sale price. The buyer also filed the copy of the sale agreement and confirmed about the exclusive access to the open area adjoining to their property which was about ₹ 12,000/- Sq feet, handed over to them by the assessee. The market value of building No.3 was ₹ 1,38,14,500/- and building No. 10 was ₹ 1,35,55,000/-. However, the sale value of building No. 3 was ₹ 4,25,00.000/- and building No. 10 was ₹ 1,60,00,000/-. Both the buildings were sold at more than the value of Stamp Valuation Authority. Thus, the Ld. A.O. observed that the assessee had received the payment of 'on money' and made an addition of ₹ 2,52,65,247/- on account of difference of sale price between the building no.3 and building No.10 sold in Shah Industrial Plaza at Sativali, Vasai (East), Thane during the financial year. On the appeal, the Ld. CIT(A) confirmed the addition made by the Ld. A.O. The assessee being aggrieved by the order passed by the Ld. CIT(A) filed the appeal before Hon'ble ITAT.

Held

Hon'ble ITAT after considering the arguments of both the parties observed that a notice under section 133(6) was issued only to the buyer of building No.3, who had paid the higher price. No notice under section 133(6) was issued to the buyer of building no.10, who purchased the flats at lower rates. Further, Hon'ble ITAT observed that the assessee sold the Building No.3 & 10 at the higher rate than the stamp value rate and there was no allegation of the Ld. A.O. that transfer of the Building No.10 was understated by the assessee. The Ld. A.O. on his suspicions about the "on money" made the addition on the basis of variation of rates between two buyers. The onus was on the Ld. A.O. to prove that the assessee received "on money" on sale of Gala No.3. The assessee throughout the proceeding had contended that the higher rate was negotiated with the purchaser of Gala No.3 because of location and the additional benefit of adjoining open space of 12,000 sq. ft. The addition was made on difference of the alleged sale price without any evidence in his possession. No enquiry was made from the purchaser of Gala No.10. Thus, Hon'ble ITAT observed that the purchaser of Gala No.10 was a crucial witness on the basis of whose transaction the difference of sale price was added. No enquiry from other purchaser was carried out by Ld. A.O., though the assessee had furnished the details of all the purchasers. Hon'ble ITAT, further, observed that it is settled law that no addition can be made on hypothetical basis or presuming a higher sale price by simply rejecting the contention without bringing cogent reason. Moreover, the higher rate of building No.3 was disclosed by the assessee in his books of accounts. Thus, Hon'ble ITAT came to the conclusion that the addition was made by the Ld.A.O. merely on assumption and presumption basis and without any evidence. Thus, Hon'ble ITAT deleted the addition made by the Ld. A.O. While coming to the said conclusion ITAT relied on the decision of *Neelkamal Realtor & Erectors India (P) Ltd (2013) 145 ITD 217(Mum-Trib.), K.P. Varghese v. ITO [1981] 131 ITR 59(SC), CIT vs. Shivakami Co. (P.) Ltd. [1986] 159 ITR 71 (SC).* Hon'ble ITAT upheld the contention of the assessee and reversed the order of the Ld. CIT(A).

5. Penalty – section 158BFA(2) of the Act – no penalty can be levied when the addition made under section 158BC did not survive in the absence of search warrant against the assessee

Sh. Ravinder Taneja vs. CIT [IT(SS)A No. 01/Del/2015] (Block period 1-4-1995 to 22-8-20010) order dated 4-7-2018

Facts

The assessee is an individual. The search and seizure action was carried on at the premises of the assessee on 22-8-2001. The assessment was completed on 31-7-2003 by passing an assessment order under section 158BC of the Act. The Ld. A.O. in the assessment order had made addition of ₹ 38,32,128/- as against the return declared by the assessee at ₹ Nil. The assesse, further, preferred the quantum appeal before the Ld. CIT(A) which was dismissed. Thus, the appeal was filed before Hon'ble ITAT which was also dismissed for non-prosecution. In the meantime, the Ld. A.O. issued a show cause notice on 24-8-2007 to the assessee for levying penalty under section 158 BFA(2) of the Act. The assessee objected to the same on the ground that no proper satisfaction was recorded. The Ld. A.O rejected the submission of the assessee and levied penalty of ₹ 23,45,262/- under section 158BFA(2) of the Act. On the appeal, the Ld. CIT(A) confirmed the penalty levied by the Ld. A.O. The assessee, therefore, filed the appeal before Hon'ble ITAT. During the course of hearing, the assessee pointed out the decision of its Co-ordinate Bench in IT (SS)A No. 307/Del/2004, dated 11-8-2017 in its own case wherein the addition in quantum proceedings was deleted.

Held

Hon'ble ITAT observed that in the order passed by its Co-ordinate Bench in the quantum proceedings, the assessment was completed under section 158BC wherein it was held that in absence of a search warrant against the assessee, the assessment completed under section 158BC is without jurisdiction and therefore, the assessment was void *ab initio*. After perusing the said order, Hon'ble ITAT came to the conclusion that the penalty levied in respect of the income assessed under the said assessment order cannot survive when the quantum proceedings were declared as null and void. The appeal of the assessee was allowed by Hon'ble ITAT by deleting the said penalty.

6. Return – Section 139(5) – There is no bar / restriction that an assessee cannot file a revised return of income after issuance of notice u/s. 143(2) of the Act. A revised return of income can be filed even in course of the assessment proceedings provided the same is filed within the time prescribed u/s. 139(5) of the Act is available. The Departmental Authorities are not expected to deny assessee's legitimate claim by raising technical objection

Mahesh H. Hinduja vs. Income Tax Officer ward 21(3)(3), Mumbai (ITA 176/Mum/2017) [Assessment Year: 2011-12] order dated 20-6-2018

Facts

The assessee is an individual and for the assessment year 2011-12 filed a return of income on 28th July 2011, declaring total income of ₹ 4,91,750 wherein neither the computation of capital gains nor the exemption of Sec 54 was claimed by the assessee. A case was selected for the scrutiny assessment and the notice u/s. 143(2) of the Act was served on the assessee. Thereafter, the assessee revised his return u/s. 139(5) of the Act offering higher rental income. Further the computation of capital gains was made and the exemption of sec 54 of the Act was claimed in the said revised return. The said return was filed within the time prescribed u/s. 139(5) of the Act. During the course of assessment proceedings, the learned assessing officer after concluding the revised return as invalid completed the assessment rejecting assessee's claim of deduction under section 54 of the Act. Aggrieved with the same, the assessee preferred an appeal before the Ld. CIT(A) but did not find any success. Finally, the matter travelled to Hon'ble ITAT. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT after perusing the facts and relevant sections of the Act came to the conclusion that the revised return filed by the assessee was within the time prescribed u/s. 143(2) of the Act. It further noted that there is no bar that an assessee cannot file a revised return of income after issuance of notice u/s. 143(2) of the Act. It further observed that the legitimate right of the assessee cannot be taken away by the department merely on the fact that the notice u/s. 143(2) was issued to him. It further observed that it is trite law, the assessee can file a revised return of income even in course of the assessment proceedings, provided, the time limit prescribed under section 139(5) of the Act is available and the return filed by the assessee in the current factual matrix cannot be held invalid. Hon'ble ITAT restored the issue back to the file of the Ld. AO and directed him to examine the claim of exemption u/s. 54 of the Act afresh. The appeal of the assessee was allowed for statistical purpose.

7. Unexplained unsecured loans – section 68 of the Act – Addition cannot be made where the assessee discharges its primary onus of providing complete details in respect of loan transactions

ACIT vs. Shreedham Builders, ITA No. 5589/Mum/2017, dated. 22-6-2018, AY 2012 – 13

Facts

The assessee is a partnership firm and engaged in business of construction of residential/commercial projects. The assessment year under consideration is 2012-13. For the year under consideration, the survey u/s. 133A was carried out at the business premises of the assessee and it was found by the department that the assessee had obtained accommodation entries in form of unsecured loans from various entities. During the course of assessment proceedings, the assessee tried to justify the genuineness of the loan transactions by placing various documents on record. However, while concluding the assessment proceedings, the Ld. AO added the said unsecured loans u/s. 68 of the Act on the contention that the assessee failed to prove genuineness of loan transactions. Aggrieved with the said order, the assessee filed an appeal before the Ld. CIT(A). The Ld. CIT(A) deleted the addition on the observation that the said unsecured loans taken by the assessee were repaid along with interest and there was no iota of evidence to prove that any cash was involved in the said loan transactions since no cash was ever found by the department during the survey proceedings. Further it was observed that the said loans were repaid before the survey proceedings and all the parties appeared before the Ld. AO during the remand proceedings also. Aggrieved with the order passed by the Ld. CIT(A), the department has preferred an appeal before Hon'ble ITAT. After hearing both the parties and perusing the material on record, Hon'ble ITAT held as under:

Held

Hon'ble ITAT noted that the loans as well as the interest on the said loans were paid through a banking channel. Further the loans were repaid prior to the survey proceedings and there was no cash found at the time of survey. Further it was observed by Hon'ble ITAT that the Ld. AO had not made any efforts to make independent enquiries with the lenders and nothing was placed on record to suggest that the information furnished by the assessee was non-genuine. The assessee proved identity, creditworthiness as well as genuineness of transactions and discharged its primary onus by providing complete details in respect of the loan transactions. Hon'ble ITAT confirmed the order passed by the Ld. CIT(A) and dismissed the appeal filed by the department.

Reported Decisions

8. In the case of conflicting decisions of different High Courts, the decision of the High Court in favour of the assessee and against the revenues is to be followed

Income Tax Officer, ward-8(4), Ahmedabad vs. Upkar Retail (P.) Ltd.

(ITA 2237/Ahd/2014) [Assessment Year: 2011-12] order dated 18-6-2018 [2018] 94 taxmann.com 450 (Mum-Trib)

Facts

The assessee is a private limited company and the assessment year under consideration is 2011-12. For the said assessment year, the department came up in appeal before Hon'ble ITAT and challenged the correctness of the order passed by the Ld. CIT(A) wherein it was held that the loss incurred on account of derivatives would be deemed business loss under proviso to section 43(5) of the Act and not speculation loss and, accordingly Explanation to section 73 of the Act could not be applied. During the course of hearing, it was fairly mentioned to Hon'ble Bench that the stand taken by the Ld. CIT(A) is in consonance with the decision of Hon'ble Calcutta High Court in the case of *Asian Financial Services Ltd. v. CIT (293 CTR 240).* However, it was further clarified that a contrary view has been taken by Hon'ble Delhi High court on the same issue. Further it was pointed out that there is no binding decision of jurisdictional High Court on the issue under consideration. In view of aforesaid facts, Hon'ble ITAT held as under:

Held

After perusing the facts and conflicting decisions of non-jurisdictional High Courts, Hon'ble Bench referred to the decision of its Coordinate Bench in the case of *"Tej International Pvt Ltd vs. DCIT (69 TTJ 650)"* and came to the conclusion that when the decision of Hon'ble non-jurisdictional High Courts are in conflict with each other, a view favourable to the assessee is required to be taken. Keeping the said well-established proposition of the law in mind, Hon'ble ITAT confirmed the stand taken by the Ld. CIT(A) and dismissed the appeal filed by the department.

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CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. Where royalty paid was already forming part of operating cost and the TPO had accepted the benchmarking under TNMM, he was not justified in separately benchmarking royalty cost and determining it ALP at Nil

Kaypee Electronics & Associates (P.) Ltd. vs. DCIT - [2018] 94 taxmann.com 251 (Kar.)

Facts

1. The appellant, a subsidiary company of Falco Ltd., Hong Kong was engaged in the business of manufacturing magnetic based electronic coils, transformers and inductors. It had entered into a technology collaboration agreement with M/s. Falco Limited for manufacturing electronic components by using technology, enterprise and know how of Falco, marketing, selling the same under the brand name of Falco, in India and abroad for which it was required to pay royalty@ 8 per cent (of its sales).

2. The TPO accepted the benchmarking of the assessee's international transactions under TNMM to be at ALP. However, the TPO separately determined the ALP of royalty payment at Nil alleging that there was no necessity to make such payment, which was confirmed by the DRP.

3. The Tribunal dismissed the assessee's contention and held that since the TPO benchmarked the royalty transaction on an independent basis, the adjustment was to be upheld.

4. Aggrieved, the assessee filed an appeal before the Hon'ble High Court contending that the Tribunal erred in passing its order without considering the decisions of the Co-ordinate Bench in *Sony Ericsson Mobile Communications India (P.) Ltd. vs. CIT [2015] 55 taxmann.com 240/231 Taxman 113/374 ITR 118 (Delhi)* and the decision of the Coordinate Bench of this Court in the case *Siemens VDO Automotive Ltd. vs. DCIT (TP) A No.923/B/2012 dated 25-1-2017* wherein it was held that as the royalty paid was already forming part of operating cost, there was no necessity of separately benchmarking royalty.

Held

1. The Court noted that the Tribunal had failed to consider the aforesaid judgments and therefore set aside the matter to the file of the Tribunal for fresh adjudication directing it to consider the aforesaid decisions.

B. AUTHORITY FOR ADVANCE RULING (AAR)

2. The liaison office of applicant, a non-profit organisation of Belgium created for the purpose of creating awareness for zinc in agricultural sector could not be construed as a Permanent Establishment in India as the activities carried on by it did not constitute business under Section 28(iii) of the Act in the absence of profit motive

International Zinc Association, In re - [2018] 94 taxmann.com 27 (AAR New Delhi)

Facts

International Zinc Association (IZA), Belgium (the Applicant), a tax resident of Belgium, is registered as an "International Non-Profit Association", which aims at sustaining long-term global demand for Zinc by creating awareness about the key end uses of Zinc, conducting programmes on its sustainability and environment etc. With the approval of the RBI, it set up a liaison office (LO) in India, for education, *inter alia*, on the importance of zinc in fertilizers as Zinc deficiency is a widespread problem in agricultural soils harming crop productivity and nutritional quality; and also to promote Zinc as an agent to galvanize steel to increase its strength and durability.

The Applicant has posed following questions to AAR:

"i) Whether LO proposed to be established by IZA in India would be liable to income-tax in India under the provisions of the Act or the provisions of India-Belgium DTAA?

ii) Whether membership fee and contribution from members received by IZA Belgium from the Indian members would be liable to Income-tax in India under the provisions of the Act or the provisions of India-Belgium DTAA?"

Ruling

i) *Vis-à-vis* the Revenue's contention that the receipts / profits derived by the Applicant constituted business receipts under Section 28(iii) (which provides that income derived by a trade, professional or similar association from specific services performed for its members is taxable as profits and gains from business or profession), the AAR held that the services provided by the Applicant could not be considered as specific services as their utility was not restricted to few beneficiaries but was made available to all its members.

ii) It noted that the services rendered by the Applicant were in the ordinary course of its activities and are as per its stated objects, which it was permitted to carry out by the RBI and was allowed to set up the LO in India and held that there were no services focused at any specific member or the benefit of which was denied to others.

iii) It held that since the LO in India had been set up on a not for profit basis, any profit earned by the Applicant was in the nature of surplus that would incidentally occur at the end of the financial year, being the difference of the receipts over expenditure which would not acquire the nature of profit, as contemplated under the Act, since the receipts were from the execution of objects that are not in the nature of business, nor intended to be so. Moreso, it noted that, such surplus, if any, was ploughed back into the organisation, again to be utilised for not for profit objects. Hence, in the absence of profit motive, it held that the provisions of Section 28(iii) were not attracted in the Applicant's case.

iv) *Vis-à-vis* the Revenue's contention that with the receipt of outside subscription, i.e. from non-members, the mutuality principle has been breached, the AAR noted that only in one event organized by it viz. IGC2014, participation/ sponsorship fees was collected with the prior approval of the RBI, considering the large scale, which required financial support from the participants and stakeholders and that the receipts were used to meet the expenses of the event. Accordingly, it held that a single isolated instance could not be construed as a violation of the mutuality principle.

v) In light of the above, the AAR held that a) the LO could not be construed as a PE in India as no business was being carried on by it and consequently held that the LO would not be subject to tax in India and b) that the membership fee received by the applicant was not taxable in India either.

3. Where applicant foreign company received non-compete fees from ADI BPO Services, an Indian Company, as a part of consideration for transfer of shares held in MPS Ltd. an Indian Company, it constituted income from "Profits and Gains of Business or Profession" as provided under section 28(va) but it could not be taxed in India in the absence of any Permanent Establishment, by virtue of Article 7 of Double Taxation Avoidance Agreement ('DTAA') between India and United Kingdom

HM Publishers Holdings Limited [2018] 94 taxmann.com 193 (AAR - New Delhi)

Facts

HM Publishers Holdings Limited (Applicant) incorporated in UK had its control and management of the affairs situated wholly outside of India and was the holding company of the Macmillan Group, a leading international publisher. It was the legal and beneficial owner of around 61.46% shares of MPS, a company incorporated in India. ADI BPO Services Private Limited (ADI) incorporated in India engaged in the business of publishing BPO services in India entered into a Share Purchase Agreement (SPA) whereby ADI purchased all the shares held by the Applicant in MPS. As per the SPA, ADI would pay the Applicant non-compete fees in addition to the share purchase price for not carrying out any business activity which could compete with MPS for a period of three years since it was in possession of confidential and proprietary information relating to the business and operations of MPS.

On the above facts, the Applicant has sought a ruling from AAR on the following question :

"Whether on the facts and circumstances of the case the non-compete fees received by the Applicant from ADI BPO Services Private Ltd., an Indian Company, as a part of the consideration for transfer of the shares held in MPS Ltd. an Indian Company, shall be chargeable under the head "Profits and Gains of Business or Profession" as provided under Section 28(va) of the Income-tax Act read with Article 7 of the Double Tax Avoidance Agreement ('DTAA') between India and United Kingdom, in absence of any Permanent Establishment of the Applicant in India?"

Held

i) The Applicant contended that the non-compete fees received by it from ADI, though would be business income u/s. 28(va), but in absence of any PE in India, the same would not be taxable in India as per Article 7 of the India-UK DTAA. Revenue contended that the non-compete fee received by the applicant was for transfer of right to carry on business covered under the definition of 'transfer' as per Sec. 2(47). Revenue further contended that when payment was made to the applicant for not carrying out a business, his right in the capital asset is extinguished and there was a transfer within the meaning of Sec. 2(47).

ii) The AAR stated that though Applicant held shares of MPS to the extent of 61.46%, the right to carry on business of publishing BPO services was with MPS and not the Applicant and therefore the Applicant could not be said to be carrying on the company's business or having a right to carry on business of a company. Accordingly, it held that the Applicant did not hold a legally enforceable right which could be treated as a 'capital asset' u/s. 2(14) and therefore no transfer of any right to carry on business would arise.

iii) Thus, it held that the fee received by the Applicant was for a negative covenant to not compete with MPS and not for transfer of any right to carry on business to the payer as contended by the Revenue. It further observed that u/s. 2(47) extinguishment of a right was permanent in nature that could not be revived. Thus, AAR noted that non-compete fee was received by Applicant for not competing with MPS for 3 years subsequent to which Applicant would be free to compete with MPS without any of the restrictions provided in the SPA. Accordingly, it held that there was no capital asset or transfer and that the receipt was business income under Section 28(va) of the Act. It dismissed Revenue's contention that Sec. 28(va) can apply only when taxpayer agrees not to carry on business which he was 'already' carrying on prior to non-compete agreement and held that Sec. 28(va) nowhere provided that the recipient of non-compete fee must already be carrying on business which he has agreed not to carry on further.

iv) It held that in the absence of any permanent establishment of the Applicant in India, such business income would not be taxable in India by virtue of Article 7 of the India-UK DTAA as the Applicant did not have a permanent establishment in India.

4. AAR held that the payments received by the non-resident applicant company from the Indian hotel owner for provision of Global Reservation Services and other services would be chargeable to tax in India under section 9(1)(i) read with Articles 5 and 7 of the India-Luxembourg DTAA as business income and was attributable to the applicant's PE in India (i.e. the Indian Hotel)

FRS Hotel Group (Lux) S.a.r.l. In re [2018] 94 taxmann.com 23 (AAR New Delhi)

Facts

The Applicant-company, incorporated under the laws of and Duchy of Luxembourg, provided services in connection with hotel management including all services that were necessary for hotel operation, such as establishing hotel standards & policies, sales and marketing, centralised reservations, etc. to meet the hotel brand requirements. The Applicant entered into a Centralised Services Agreement (CSA) with Bengal Ambuja Housing Development Limited (BAHDL / Indian hotel owner) under which the Applicant agreed to provide certain Global Reservation Services and other services in different phases of hotel development and operation so that the hotel property i.e. Swissotel Kolkata could be developed and operated as per international standards.

On the above facts, the applicant sought a ruling from AAR on the following question :

"Whether payments received by the Applicant from the Indian hotel owner for provision of global reservation services (GRS) would be chargeable to tax in India as 'Fees for Technical Services' or 'Royalty' under the provisions of section 9(1)(vi) / 9(1)(vii) read with provisions of Article 12 of the Double Taxation Avoidance Agreement between India and Luxembourg?"

Ruling

i) At the outset, AAR rejected Applicant's stand that it was not empowered to determine the existence of Permanent Establishment (PE) in the present application as the question was limited to whether GRS constituted royalty or FTS. Referring to the facts of the case and the powers of AAR as laid down in Rule 12 of the AAR (Procedure) Rules 1996, it ruled that AAR not only had the power but the duty to look at "all aspects of the questions set forth which would enable to it pronounce a ruling "on the substance of the questions posed for its consideration". Thus, AAR held that the present application called for an adjudication on the issue of the existence of a PE in India.

ii) AAR took note of the four other agreements also along with CSA, viz., Hotel Management Agreement, Hotel Licence Agreement, Hotel Advisory Agreement, Technical Services Agreement and observed that some very vital aspects of development, operation and management of the hotel were handed over by BAHDL to the Applicant. It rejected Applicant's contention that the ruling was to be restricted only to the CSA, observing that these agreements contained references to each other at several places and were co-terminus with each other as well. AAR held that each of these agreements dealt with parts of the overall functioning of the hotel.

iii) Referring to model commentaries, leading commentaries by eminent authors on the subject and also the decision in the case of *Formula One World Championship Ltd. vs. CIT (2017) 394 ITR 80 (SC)*, AAR observed that three conditions to be fulfilled for a fixed place PE are i) existence of a fixed place, ii) the fixed place being at the disposal of the non-resident, iii) the non-resident carrying on its business (wholly or partly) through such fixed place. AAR held that the Indian hotel, Swissotel Kolkata, satisfied all the three tests and thus, constituted a fixed place PE of the Applicant with respect to various income sources. In this regard, AAR observed that -

– As per a careful analysis of the terms of all the agreements, it could be said that the Hotel was completely at the disposal of the Applicant.

– At the very stage of inception, i.e. the construction of the Hotel, the Applicant was called upon to oversee the design and construction of the property to ensure that it was compliant with the brand standards of the Applicant.

– Once the hotel was constructed, its operation and management rested with the Applicant and BAHDL had undertaken that it would not interfere in the applicant's exercise of the exclusive authority over such operation and management.

– Further, the owner was bound to the terms of this agreement for a period of 10 years extendable by another 40 years (Hotel management agreement).

– Furthermore, some of the core functions of the operation of the hotel such as sales and marketing, reservation etc. were also outsourced to the Applicant.

iv) AAR also rejected Applicant's contention that all of the alleged activities performed by the Applicant were done in the capacity of agents of BAHDL, hence, these activities did not constitute carrying on of the Applicant's business in India, observing that –

– The Applicant was carrying on such business operations through its senior management or employees who may be called by any name

– The entire risk was of the Applicant.

– The final decision in respect of all of the important functions relating to the operation and management of the hotel was in the hands of the Applicant.

– Arrangements of such kind could only exist in a principal-to-principal agreement and thus the Principal-agent relationship was completely non-existent.

v) Thus, AAR held that the Applicant was carrying on its entire business operations from the fixed place i.e. the Indian Hotel and the existence of a PE of the applicant in India got established within the meaning of Article 7 of the DTAA.

vi) AAR held that since, in the present case, it had held that the income of the Applicant was attributable to the fixed place PE in India, the question whether it could be characterised as "royalty" or "fees for technical services" became wholly academic since even if the income was characterised as either of these two, by virtue of para 4 of Article 12, the income would still be taxable as "business profits" under Article 7.

vii) Thus, AAR held that the payments received by the applicant from the Indian hotel owner for provision of GRS would be chargeable to tax in India under section 9(1)(i) read with Articles 5 and 7 of the India-Luxembourg DTAA as business income and was attributable to the Applicant's PE in India.

5. Considering the nature of business support/marketing support activities proposed to be undertaken by Indian subsidiary of a Saudi Arabian company, AAR held that the said subsidiary would not create a PE for the Applicant in India under Article 5 of India-Saudi Arabia DTAA, where such activities of the Indian subsidiary are duly compensated on an Arm's Length basis in accordance with the Indian transfer pricing laws and regulations.

Saudi Arabian Oil Company, In re [2018] 94 taxmann.com 194 (AAR New Delhi)

Facts

i) The applicant, a State owned oil company of Kingdom of Saudi Arabia and world's largest crude oil exporter, had set up a subsidiary, Aramco India, as a separate legal entity, to provide procurement related support services and to create awareness about Aramco and Saudi Arabian crude oil amongst crude buyers and refineries in India.

ii) The Applicant proposed to set up a support team in Aramco India which would closely co-ordinate and extend required support to Saudi Aramco's Crude Oil Sales and Marketing Department for providing business support/ marketing support function. However, the negotiation of the material terms or conclusion of contracts with Indian customers as well as signing of such contracts for and on behalf of the applicant would only be carried out by Applicant's own employees based in Saudi Arabia. Aramco India, however, was only to provide certain support in furtherance of the above sales operations. It would be helping in strategic sourcing and registration of major Indian oil and gas equipment manufactures and engineering procurement and construction (EPC) contractors, performing engineering and inspection evaluations, and plant audits for identified manufacturers and suppliers. It would also be supporting Saudi Aramco and other group companies with any additional material supply support.

On the above facts, the Applicant sought a ruling from AAR on the following question:

Based on the nature of business support/ marketing support activities proposed to be undertaken by Aramco India, as stated above, would Aramco India create a Permanent Establishment (PE) for the Applicant in India under Article 5 of India-Saudi Arabia DTAA, where such activities of Aramco India are duly compensated on an Arm's Length basis in accordance with the Indian transfer pricing laws and regulations?

Ruling

i) Article 5 of the India-Saudi Arabia DTAA envisages 3 types of PEs, namely, (i) Fixed Place of Business PE, (ii) Service PE, and (iii) an Agency PE.

ii) Fixed Place PE

– Referring to the Klaus Vogel Commentary on Double Taxation Convention, AAR observed that unless the Applicant proposed to carry out its main business itself from an establishment in India, or through its employees and personnel, or the Indian subsidiary acted as an agent of the holding company, it could not automatically be concluded that Aramco India would constitute a PE of the Applicant.

– Noting that Aramco India had its own Board of Directors and was carrying out/ will carry out its activities in consonance with its objects outlined in the services agreement and the Proposed Addendum, it held that Aramco India was utilising its establishment for its own business in India and was providing support services to the Applicant, for which it got duly remunerated.

– Further, noting that no material was brought on record to show that the support team in Aramco India was manned by employees or hired personnel of the Applicant, or would be so manned in future when the activities begin, it held that the support team was only a part of Aramco India to provide the support services and it could not be said that the Applicant would carry out its main business (which was production and sale of oil and which was done from Saudi Arabia) through the latter or that any part of the said premises had been placed by Aramco India at the disposal of the Applicant.

– Thus, it held that the Applicant could not be said to have a Fixed place PE in India, within the meaning of para 1 of Article 5 of the India-Saudi Arabia DTAA.

iii) Service PE

– With respect to department's contention that one of the directors of Aramco India was a high dignitary of Saudi Aramco group and had the power to control the activities of the Indian subsidiary, AAR observed that the information culled out by the Revenue from the internet showed that most of the appointments in high positions mentioned by the Revenue pertained to period prior to the Service Agreement under consideration. Further, it held that the role of the Directors, wherever stationed, was only for Aramco India, being its Directors, which was providing services to the Applicant, rather than for providing services to the customers of the Applicant, since Aramco India itself was set up to provide services to the Applicant. The Applicant had also submitted that none of the Directors of Aramco India were employees of the Applicant.

– Thus, AAR held that Aramco India could not be held to be a Service PE of the Applicant as per the clauses of the Agreements, and within the meaning of Article 5(3) of the India-Saudi Arabia DTAA.

iv) Agency PE

– On perusal of the clause in the Proposed Addendum, AAR held that the Applicant had retained with itself the authority, regarding its main business, to finalise its marketing strategies, finalise terms of the contracts directly with the customers, and to accept or reject offers of customers. Thus, Aramco India would be left only to provide support services rather than act as an Agent of the Applicant. Therefore, Aramco India could not be termed as an Agency PE of the Applicant.

v) Accordingly, it held that based on the nature of business support/marketing support activities proposed to be undertaken by Aramco India, it would not create a PE for the Applicant in India under Article 5 of India-Saudi Arabia DTAA, where such activities of Aramco India are duly compensated on an Arm's Length basis in accordance with the Indian transfer pricing laws and regulations.

C. TRIBUNAL

6. Taxation of FTS – Make Available-Article 12 of India-U.S. DTAA. Mere rendering of services involving technical knowledge, skill etc. is not sufficient; person utilising services should be able to make use of such technical knowledge, skill etc. on his own and without recourse to service provider in future – Payment did not qualify as Fees for Included Services – Not-Taxable in India – Held in favour of the assessee

ACIT vs. Petronet LNG Ltd. [2018] 92 taxmann.com 407 (Delhi - Trib.) Assessment Year: 2006-07

Facts

i) The assessee had made payments to U.S. company for rendering services in connection with review of the alternative vaporisation process for the LNG terminal and recommend a suitable process to the assessee. The scope involved study of the benefits of the various schemes for generating power through the utilisation of LNG.

ii) The Assessing Officer disallowed the claim of deduction under section 40(a)(i) holding that the payments were in the nature of fee for technical services under the Act and, accordingly, tax should have been withheld on the same. The Commissioner (Appeals) deleted the disallowance.

Tribunal's Decision

On Department's appeal, the Tribunal held in favour of the assessee as under:

i) The provisions of the India-US treaty provide for a restrictive meaning of 'fee for included services' *vis-a-vis* the meaning of fee for technical services under the Act in as much as only those technical/consultancy services which are ancillary and subsidiary to the application/ enjoyment of right, property or information or which 'make available' technical knowledge, skill, knowhow, process etc would be liable to tax.

ii) Thus, in accordance with the MOU, technology will be considered to be 'made available' when the person acquiring the service is able to apply such technology on his own.

iii) On the basis of details furnished by the assessee along with the copy of the letter of award issued to Fluor, it may appear that the same involves use of technical knowledge or skill and will qualify as fees for technical services, as defined in Explanation 2 to section 9(i)(vii). However, Article 12(4) of the India-USA DTAA dealing with fee for included services requires that technical knowledge, experience skill etc. as provided in the definition of the term 'fee for technical services' should be 'made available' to the recipient of such services. An analysis of the MOU to the India-US DTAA concerning the said clause indicates that in order to fall within the ambit of the said Article 12, mere rendering of services involving technical knowledge, skill etc., is not sufficient. It contemplates that the person utilising the service should be able to make use of such technical knowledge, skill etc. on his own and without recourse to the service provider in future.

iv) The scope of the services agreed with Fluor involved evaluation of different types of LNG vaporisers, recommendation of a suitable form of vaporiser and study of the benefits of various schemes for generating power through utilisation of LNG. These services involved deployment of personnel having the requisite experience and skill to perform the services.

v) However, it is not possible that the assessee would be able to carry out such services in future on its own without recourse to the service provider to fall within Article 12(4) of the India-US DTAA. The nature of services rendered does not indicate making available technical knowledge, skill, know-how etc. to the assessee.

vi) Thus, said payment did not qualify as fee for included services as per the provisions of the India-US DTAA. Although the revenue has argued vehemently against the action of the Commissioner (Appeals) in deleting this addition, he could not point out any factual or legal inaccuracy in the finding recorded by the Commissioner (Appeals). Accordingly, there is no reason to interfere with the findings of the Commissioner (Appeals).

7. Explanation 2 to Section 9(1)(vii) – Scope of Ambit of definition of FTS – Payments to foreign party towards supervision of installation of pipes and fittings, since payment in respect of assembly of project, which squarely fall within sweep of exceptions carved out in Explanation 2 to section 9(1)(vii) and thus could not be held as FTS – Held in favour of the assessee.

Chemical Process Piping (P.) Ltd. vs. R.M. Madhavi [2018] 94 taxmann.com 116 (Mumbai-Trib.) Assessment Years : 2011-12 & 2012-13

Facts

i) The assessee-company was engaged in the business of export of special pipes. During relevant year, the Assessing Officer made payment to 'T', Slovania towards supervision charges. The assessee's case was since 'T' was a non-resident concern having no PE in India and, moreover, services were rendered outside India, there was no requirement to deduct tax at source while making payment of supervision charges.

ii) The Assessing Officer opined that payment to the foreign party was made by the assessee towards consultancy charges, viz., excel programme for calculation of the pipe thickness in base of TUV report, excel programme for underground pipe verification according to the relevant AWWA standard, and fabrication trading for steel moulds for construction of the bell and for coupling. The Assessing Officer thus characterising the services rendered by the said party as technical consultancy charges/testing charges, opined that as the assessee had failed to deduct tax at source from the above payments as per the provisions of section 195, therefore, the said amount was liable to be disallowed under section 40(a)(i). The Commissioner (Appeals) confirmed said disallowance.

Tribunal's Decision

On Appeal, the Tribunal held in favour of the assessee as under:

i) It is found from material on record that the payment was made by the assessee to the foreign party towards supervision charges for installation of GRP pipes manufactured by the assessee. It is opined that such consideration paid by the assessee to 'T', Slovania towards supervisions of the installation of the GRP pipes and fittings can safely be characterised as having been made in context of assembly project undertaken by the latter. As the payment made by the assessee to 'T' was in respect of an assembly project, the same would squarely fall within the sweep of the exceptions carved out in *Explanation 2* to section 9(1)(vii), and thus could not be held as FTS.

ii) Thus, the assessee being under no obligation of deducting tax at source under section 195 on the aforesaid payment made to 'T', Solvania, the same could not have been disallowed under section 40(a)(i) in the hands of the assessee. Thus, the order of the Commissioner (Appeals) in context of the aforesaid issue is set aside and the disallowance under section 40(a)(i) is deleted.

8. DTAA with UK and Canada – Taxability of Sales Commission on Exports as FTS – Whether process of procuring orders by non-resident could not be termed as managerial service, which could fall under 'fee for technical services' as defined in *Explanation 2*

below section 9(1)(vii) – Held, yes – Whether, on facts, sales commission payment was not taxable in India – Held, Yes

ACIT vs. Evergreen International Ltd. [2018] 91 taxmann.com 111 (Delhi - Trib.) Assessment Year : 2010-11

Facts

i) The assessee company was 100 per cent export house, exporting leather garments and furniture etc. It paid sales commission to two foreign agents. No tax was deducted by the assessee on the said commission payments.

ii) The Assessing Officer held services provided by a non-resident foreign agents were managerial services and had been utilised in India and, therefore clearly fell within the ambit of 'income deemed to accrue or arise in India' and taxable under section 9(1)(i) and 9(1)(vii)(b). Since tax was not deducted by the assessee on the said payment, the Assessing Officer disallowed the payment under the provisions of section 40(a)(i).

iii) The Commissioner (Appeals) deleted the addition holding that both foreign agents were non-resident and no part of services were rendered in India and they did not have permanent establishment in India, and thus, the payment was not chargeable to the tax in India.

iv) On appeal, the revenue submitted that by way of Circular No. 7/2009 dated 22-10-2009, the earlier circulars issued by the Central Board of Direct Taxes (CBDT) i.e. the Circular No. 163 dated 29-5-1975 and Circular No. 786 dated 7-2-2000 have been withdrawn, which provided clarification in respect of certain provisions of circular No. 23 dated 23-7-1969. According to her, in view of the withdrawal of the circulars, the payment made by the assessee to the non-resident was income accrued or arisen from business connection in India and, thus, in view of non-deduction of tax at source, said payments was liable for disallowance under section 40(a)(i).

Tribunal's Decision

On appeal, the Tribunal held in favour of the assessee as under:

i) It is settled position that circulars are binding on the authorities under the CBDT but these are not binding on the Tribunal. As per section 119 the CBDT is empowered to issue orders, instructions, or directions to all the Incomes-tax Authorities working under it for proper administration of the Act and it has also been provided that they shall be binding upon the Income-tax Authorities. A provision has been inserted to sub-section (1) of section 119, which says that no such orders, instructions or directions shall be issued: (a) so as to require any Income-tax Authority to make a particular assessment or dispose a particular case in a particular manner; or (b) so as to interfere with the discretion of the Commissioner (Appeals) in exercise of his appellate functions. It is evident from the above proviso that the CBDT has neither the power to decide the taxability of particular receipt nor it has power to interfere with appellate functions of the Commissioner (Appeals). Therefore, there is no question of there being any binding effect of the circular on the Tribunal and the issue of the taxability of payment to non-resident agents has to be decided in accordance with law.

ii) The term "business connection" has been defined in *Explanation-2* below section 9(1)(i), which was inserted by Finance Act, 2003 with effect from 1-4-2004. The business connection defined is identical to dependent agent Permanent Establishment (PE) in DTAA.

iii) In the instant case, the Assessing Officer has not made any efforts to establish any "business connection" for invoking section 9(1)(i). In absence of establishing any "business connection", the action of the Assessing Officer in holding that income accrued or arisen in the hand of non-resident through or from any business connection in India is not justified. The Assessing Officer has also not established that the non-resident was having any permanent establishment in India, and, thus, in terms of Double Tax Avoidance Agreement (DTAA) with relevant countries i.e.

Canada and UK also income of the non-residents was not taxable as business income in India.

iv) Another section, relied upon by the Assessing Officer for holding that the income has accrued or arisen in the hands of non-resident, is section 9(1)(vii)(b). According to the said section income by way of fees for technical services payable by a person who is a resident is deemed to accrue or arise in India, except where the fees are payable in respect of the services utilized in the business or profession carried on by such person outside India or for the purpose of making or earning any income from any source outside India. Further, the *Explanation-2* below the said sub-section 9(1)(vii) has defined the term 'fee for technical services'.

v) Evidently, the services of procuring export order does not fall either in the technical or consultancy services. The contention of the Assessing Officer is that said services are managerial services and, thus, fall under fee for technical services. The Assessing Officer has not made any attempt as to how the said services of procuring order are managerial services. The Assessing Officer has failed to discharge his onus in this regard.

vi) According to the assessee, the managerial services though not defined in the Act, but as per normal ordinary business meaning, it covers services rendered in performing management functions which relates to running a business or handling of manpower and related affairs etc. but it cannot cover the services of foreign agent of procuring export orders, in the instant case.

vii) On perusal of the submission of the assessee and order of the lower authorities, the non-resident has rendered services of booking export order from foreign buyers. In the process of procuring export orders, the non-resident displays or demonstrates the goods of the assessee to the foreign buyers. If the foreign buyer place any order for purchase of those goods, the non-resident agent forwards those purchase orders to the assessee. For rendering the services of procuring orders, the assessee pays certain commission at the rate of percentage agreed by the non-resident agent. This entire process of procuring orders by the non-resident cannot be termed as managerial service, which could fall under fee for technical services as defined in *Explanation-2* below the section 9(1)(vii).

viii) Further, the assessee has claimed that no part of services was rendered in India. The contention of the revenue is that in view of the *Explanation* inserted below section 9(2) by Finance Act, 2010, now even if services are rendered outside India, same may fall under fee for technical services.

ix) Thus, according to the above *Explanation* irrespective of the fact whether the non-resident has a residence or place of business or business connection in India or the non-resident has rendered services in India, income of non-resident for the purpose of clause (vii) i.e. fee for technical services shall be deemed to accrue or arise in India. The contention of revenue that this amendment has been introduced by Finance Act, 2010, which received assent of the President on the 8th May 2010, whereas the financial year pertained in the case of the assessee is 2009-10 which ended on 31-3-2010, therefore, the assessee had no occasion to know/believe that tax was to be deducted irrespective to the place of rendering service. Thus, the assessee cannot be made liable for deduction of the tax at source in view of a retrospective amendment to section 9.

x) Before the Commissioner (Appeals), the assessee also contended that in terms of DTAA both in case of the Canada and the UK, for taxability of fee for technical services, the services should make available 'technical knowledge' to the assessee and the said condition has not been fulfilled.

xi) It is a settled position that the assessee has a choice of applying either the provisions of the DTAA or the Income-tax Act, whichever is more beneficial to him. In view of the articles of the DTAA, for holding the fee for technical services as liable to tax in source country, the services should make available the technical knowledge etc. to the assessee of the source country. In instant case, the Assessing Officer has not been able to establish that the services of procuring orders has made available any technical knowledge, experience, skill know-how etc. to the assessee, and, therefore, the services rendered by the non-resident agents cannot be taxed as fee for technical services under the DTAA.

xii) In view of the above discussion, income from services of the non-residents of procuring orders are not chargeable to tax in India and, therefore, assessee was not liable to deduct tax at source on the payments of commission made to those agents, accordingly, no disallowance could have been made under section 40(a)(i).

[Note: The reader may also refer to the latest favourable decision of Mumbai Tribunal in a similar matter in ITO vs. Indo Industries Ltd. (2018) 94 Taxmann.com 180 (Mumbai Tribunal) dated 11-5-2018].

9. Section 9(1)(vii)(b) – Payment made by an Indian company to a person outside India for earning income from any source outside India, shall be excluded from deeming provision of section 9(1) – Held in favour of the assessee

Nissan Motor India (P.) Ltd. vs. DCIT [2018] 92 taxmann.com 127 (Chennai - Trib.) Assessment Year: 2014-15

Facts

i) The assessee was a resident private limited company, engaged in the business of manufacturing and selling motor cars in India as well as abroad. It also provided warranty to the end customers who purchased the car and the assessee's sister companies maintained the cars sold by them according to the terms of the warranty promised by the assessee company, towards which the dealer companies incurred expenditure. As per the contractual obligation, the assessee company reimbursed such expenses incurred by its dealer-sister companies.

ii) The Assessing Officer had held that the payments made by the assessee towards reimbursement of warranty expenditure to its group entities outside India was in the nature of payment made towards 'fees for technical services (FTS)' and, accordingly, taxable income in India.

iii) The Assessing Officer had invoked the provisions of section 195 and disallowed the expenditure incurred by assessee towards purchase of software from tax resident of Japan and United Kingdom by treating it as taxable income in India in the hands of the assessee under the head 'royalty' as per provisions of section 9(1)(vi).

Tribunal's Decision:

On Appeal, the Tribunal held in favour of the assessee as under:

i) The provision of section 9(1)(vii)(b) clearly provides that where a resident is liable to pay fees in respect of services utilised in a business or profession carried on by such person for the purpose of making or earning any income from any source outside India, the income arising from such payment shall be excluded from the deeming provision of section 9(1) viz., "income accruing or arising in India". In the case of the assessee, the assessee was a manufacturer of motor cars in India and exported the motor cars to other countries through its sister concerns who acted as the dealer of the assessee-company. It also provided warranty to the end customers who purchased the car and the assessee's sister companies maintained the cars sold by them according to the terms of the warranty promised by the assessee-company, towards which the dealer companies incurred expenditure. As per the contractual obligation, the assessee company reimbursed such expenses incurred by its dealer – sister companies. The assessee company incurred expenditure outside India for the purpose of earning income from source outside India. Therefore, by virtue of section 9(1)(vii)(b), the payment made by the assessee company to a person outside India for earning income from any source outside India, and the income arising from such payment to him shall be excluded from the deeming provision of section 9(1). Hence, the assessee company will not be liable to deduct tax under section 195.

10. Disallowance u/s. 40(a)(i)- Commission paid to non-residents for services of mobilizing deposits, etc., a non-resident not having any business operations in India – commission earned by them for rendering services abroad could not be construed as income accrued or arisen in India – No disallowance u/s. 40(a)(i).

State Bank of India vs. ACIT [2018] 91 taxmann.com 312 (Mumbai - Trib.) Assessment Year: 1999-2000

Facts

i) During the relevant year, the assessee-bank launched foreign currency denominated Resurgent India Bonds Scheme (RIBS).

ii) The Assessing Officer noted that certain amount was incurred on law charges, advertisement and commission by way of payment to non-residents. The Assessing Officer finding that assessee did not deduct tax at source while making payments to non-residents, disallowed said payments. The Commissioner (Appeals) confirmed the disallowance made by Assessing Officer.

Tribunal's Decision:

On Appeal, the Tribunal held in favour of the assessee as follows:

The expenditure has been paid towards the services in connection with the issue of RIBS and are in the nature of advertisements, collecting bank commission etc. Broadly speaking the payments are in the nature of commission paid to non-residents for services of mobilizing deposits, etc. showing that the services have been rendered abroad. It is also not the case of the Assessing Officer that any of the non-residents in question have any business operation in India. Therefore, in the said background, the ratio of the judgment of Supreme Court in case of *CIT vs. Toshoku Ltd. [1980] 125 ITR 525* is clearly attracted which lays down that commission earned by non-resident for services rendered abroad could not be construed as income accrued or arisen in India. Thus, on this point itself, the stand of the assessee is allowed and accordingly the disallowance made by lower authorities by invoking section 40(a)(i) is hereby set aside.

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CA Samir Kapadia

INDIRECT TAXES

GST Gyan

Free Supplies under GST

Distribution of power to tax

Prior to the implementation of the Goods and Services Tax legislation, the powers for taxing goods and services were distributed between the Central Government and the State Government. In case of goods, the Central Government had the power to tax goods at the (a) time of import into India, (b) manufacture of goods, (c) value addition up to the factory gate, and (d) inter-State trade/movement of goods, whereas the State Government was empowered to tax the value added after the factory gate and all transactions/movements within the State. The Central Government and each of the State Governments had enacted separate legislation for this purpose. The powers for taxation of services, unlike goods, was restricted to the Central Government only.

Multiple legislations – issues, limitations, and disputes

Given the distribution of powers to tax goods and services, the Central and State legislation separately defined different taxable event and prescribed compliance procedures to help them administer the tax legislation. One undesirable common factor among all the legislation was that the taxes paid under one legislation were not creditable against taxes payable under the other. This caused overlaps and cascading of taxes and led to disputes not only between the Government and the taxpayers but also between 2 or more Governments i.e. Central Government vs. State Government as well as between two State Governments. Whilst, disputes between the Government and the taxpayers were in relation to taxing events i.e. whether or not the activity amounted to manufacture or a resale of the same goods, on the other hand disputes between the Central Government and the State Governments were linked to the power to collect tax and the disputes were in relation to characterisation of a transaction into one pertaining to goods or to services, whereas the disputes between two or more State Governments related to issues such as whether a sales was in the course of inter-State sale or was merely a branch transfer.

Taxation of transactions involving goods and services

Taxation of goods or services on a standalone basis was by itself a complicated affair, taxation of transactions which involved both goods and services was even more complex, especially when the transaction was indivisible one i.e. involving both goods and services, and wherein it was difficult to allocate and tax individual components of goods and services. As a matter of fact, it was nearly impossible to lay down a set of tests/ principles which one could follow to easily and correctly determine the value of goods and services individually. While presumptive taxation provided certainty, it was not perfect and had its pitfalls, but the Governments and the taxpayers knew that there were no alternatives.

Means and measures adopted for boosting tax collections

Apart from levying multiple taxes and providing for different stages at which one or more taxes would be collected, the Central and State Governments also resorted to various means and measures to enhance and protect their tax bases and to boost their tax collections, one such means/ measure was altering the value on which tax was levied or moving away from the transaction value and providing an artificially derived or a presumptive value for the purpose of levy of tax in some cases this entailed levying tax on a pre-fixed value at a fixed (concessional) rate or in some rare cases the entire contract value was taxed at a concessional rate of tax, etc.

Here too, the Government's efforts were met with limited success given the fact that taxpayers had to pay a steep cost for taking benefit of these concessions. Instances of this include restrictions on inter-State purchases, or on claiming input tax credits, etc.

To illustrate the above, Rule 2A of the Service Tax (Determination of Value) Rules, 2006 gives the methodology for determining the value of service portion in the execution of a works contract. The Rule provides a deduction method whereby a service provider starts with the contract value and deduct therefrom various components related to supply of goods and the residual value arrived at thereafter is treated as the service portion in the works contract. For this purpose, 'total amount' has been explained to mean the sum total of the gross amount charged for the works contract and the ***fair market value of all goods and services supplied in or in relation to the execution of the works contract, whether or not supplied under the same contract or any other contract, after deducting the amount charged for such goods or services, if any; and the value added tax or sales tax, if any, levied thereon*** (emphasis supplied). Further Rule 5 of the aforesaid Rules prescribes that where any expenditure or costs are incurred by the service provider in the course of providing taxable service, all such expenditure or costs shall be treated as consideration for the taxable service provided or to be provided and shall be included in the value for the purpose of charging service tax on the said service. Such a rule was introduced to prevent taxpayers from taking resorting to various strategies such as value shifting, adding layers to a single transaction or in some cases splitting one single transaction into separate deliverables with separately specified prices, etc. Several questions were raised these included: whether such artificial additions to the gross value charged/ consideration received providing services was legally permissible. One such dispute travelled all the way to the Supreme Court (refer the case of *Commissioner of Service Tax vs. M/s. Bhayana Builders (P) Ltd. 2018-TIOL-66-SC-ST)*. The question before the Supreme Court was:

'Whether the value of the material supplied by the recipient of the taxable service free of cost (hereinafter, for convenience referred to as "free supplies") should also be included, for availing the benefits under Notification No. 15/2004-ST, dated 10-9-2004 as amended by Notification No. 4/2005-ST dated 1-3-2005.?'

The Supreme Court observed that:

the value on which service tax is payable has to satisfy the following ingredients:

a. Service tax is payable on the gross amount charged:- ***the words "gross amount" only refers to the entire contract value between the service provider and the service recipient. The word "gross" is only meant to indicate that it is the total amount charged without deduction of any expenses. Merely by use of the word "gross" the Department does not get any jurisdiction to go beyond the contract value to arrive at the value of taxable services. Further, by the use of the***

word "charged", it is clear that the same refers to the amount billed by the service provider to the service receiver. Therefore, in terms of Section 67, unless an amount is charged by the service provider to the service recipient, it does not enter into the equation for determining the value on which service tax is payable.

b. ***The amount charged should be for "for such service provided": Section 67 clearly indicates that the gross amount charged by the service provider has to be for the service provided. Therefore, it is not any amount charged which can become the basis of value on which service tax becomes payable but the amount charged has to be necessarily a consideration for the service provided which is taxable under the Act. By using the words "for such service provided" the Act has provided for a nexus between the amount charged and the service provided. Therefore, any amount charged which has no nexus with the taxable service and is not a consideration for the service provided does not become part of the value which is taxable under Section 67. The cost of free supply goods provided by the service recipient to the service provider is neither an amount "charged" by the service provider nor can it be regarded as a consideration for the service provided by the service provider.*** In fact, it has no nexus whatsoever with the taxable services for which value is sought to be determined.

Ruling in favour of the assessee the Supreme Court *inter alia* held that:

> ***'the definition of "gross amount charged" given in Explanation (c) to Section 67 only provides for the modes of the payment or book adjustments by which the consideration can be discharged by the service recipient to the service provider. It does not expand the meaning of the term "gross amount charged" to enable the Department to ignore the contract value or the amount actually charged by the service provider to the service recipient for the service rendered. The fact that it is an inclusive definition and may not be exhaustive also does not lead to the conclusion that the contract value can be ignored and the value of free supply goods can be added over and above the contract value to arrive at the value of taxable services. The value of taxable services cannot be dependent on the value of goods supplied free of cost by the service recipient.*** *The service recipient can use any quality of goods and the value of such goods can vary significantly. Such a value, has no bearing on the value of services provided by the service recipient.* ***Thus, on first principle itself, a value which is not part of the contract between the service provider and the service recipient has no relevance in the determination of the value of taxable services provided by the service provider'.*** (emphasis supplied)

Implementation of the Goods and Service tax legislation

The Goods and Services Tax legislation ('GST legislation') has been implemented with effect from 1st July, 2017. This legislation is unique in the sense that (a) the Central & the State Governments have concurrent powers to levy tax (GST) on goods as well as services, (b) the tax is levied a single tax on every supply of goods and services, (c) it is collected at every stage right from the stage import or manufacturer up to the final sale to consumer, and (d) wherein credits of input taxes paid at each stage are available to offset the output tax liability incurred at the subsequent stage of value addition, essentially making it a tax only on value addition at each stage.

Supply under CGST Act

Under the Central Goods and Services Tax Act, 2017 ('CGST Act'), 'supply' has been defined under Section 7 to include:

> *" [..]*

(a) ***all forms of supply of goods or services or both*** *such as sale, transfer, barter, exchange, licence, rental, lease or disposal made or agreed to be* ***made for a consideration*** *by a person* ***in the course or furtherance of business****;*

(b) *import of services for a consideration whether or not in the course or furtherance of business;*

(c) ***the activities specified in Schedule I, made or agreed to be made without a consideration****; and*

(d) ***the activities to be treated as supply of goods or supply of services as referred to in Schedule II.***

(2) *Notwithstanding anything contained in sub-section (1),—*

(a) *activities or transactions specified in Schedule III; or*

(b) *such activities or transactions undertaken by the Central Government, a State Government or any local authority in which they are engaged as public authorities, as may be notified by the Government on the recommendations of the Council, shall be treated neither as a supply of goods nor a supply of services.*

(3) *Subject to the provisions of sub-sections (1) and (2), the Government may, on the recommendations of the Council, specify, by notification, the transactions that are to be treated as—*

(a) *a supply of goods and not as a supply of services; or*

(b) *a supply of services and not as a supply of goods.*

[..]"

SCHEDULE I

ACTIVITIES TO BE TREATED AS SUPPLY EVEN IF MADE WITHOUT CONSIDERATION

1. *Permanent transfer or disposal of business assets where input tax credit has been availed on such assets.*

2. *Supply of goods or services or both between related persons or between distinct persons as specified in section 25, when made in the course or furtherance of business:*

Provided that gifts not exceeding fifty thousand rupees in value in a financial year by an employer to an employee shall not be treated as supply of goods or services or both.

3. *Supply of goods—*

(a) *by a principal to his agent where the agent undertakes to supply such goods on behalf of the principal; or*

(b) *by an agent to his principal where the agent undertakes to receive such goods on behalf of the principal.*

4. *Import of services by a taxable person from a related person or from any of his other establishments outside India, in the course or furtherance of business.*

(emphasis supplied)

In this regard consideration has defined as under:

(Quote)

(31) *"consideration" in relation to the supply of goods or services or both includes—*

(a) *any payment made or to be made, whether in money or otherwise, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy*

given by the Central Government or a State Government;

(b) the monetary value of any act or forbearance, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person but shall not include any subsidy given by the Central Government or a State Government:

Provided that a deposit given in respect of the supply of goods or services or both shall not be considered as payment made for such supply unless the supplier applies such deposit as consideration for the said supply;

From the above, it can be inferred that generally existence of a consideration is a pre-requisite before a transaction can be characterized as a supply and that GST is leviable only when supplies are made for a consideration. This general condition is done away in case of certain supplies which are specified under Schedule I of the Act, many of which were hitherto not subjected to tax, for instance, stock transfers to inter-State branches or to agents or vice versa, etc. Thus, the question arises, since under GST only those supplies which have been made for a consideration are subjected to tax, whether the issue of taxing free supply has finally been put to rest?. To answer this, we will have to dive deeper and examine the (if one may be permitted to say) 'booby-trapped' provisions of CGST Act.

Taxable supply and valuation thereof under the CGST Act

The levy and collection of tax are provided for under Section 9 of the CGST Act. Per Section 9(1) of the CGST Act,

"Subject to the provisions of sub-section (2), there shall be levied a tax called the central goods and services tax on all intra-State ***supplies of goods or services or both, except on the supply of alcoholic liquor for human consumption, on the value determined under section 15*** *and at such rates, not exceeding twenty per cent., as may be notified by the Government on the recommendations of the Council and collected in such manner as may be prescribed and shall be paid by the taxable person."* (emphasis supplied)

In this regard, Section 15 of the CGST Act inter alia provides that:

'The value of a supply of goods or services or both shall be the transaction value, which is the price actually paid or payable for the said supply of goods or services or both where the supplier and the recipient of the supply are not related and the price is the sole consideration for the supply.

(2) The value of supply shall include——

(a) any taxes, duties, cesses, fees and charges levied under any law for the time being in force other than this Act, the State Goods and Services Tax Act, the Union Territory Goods and Services Tax Act and the Goods and Services Tax (Compensation to States) Act, if charged separately by the supplier;

(b) any amount that the supplier is liable to pay in relation to such supply but which has been incurred by the recipient of the supply and not included in the price actually paid or payable for the goods or services or both; (emphasis supplied)

(c) incidental expenses, including commission and packing, charged by the supplier to the recipient of a supply and any amount charged for anything done by the supplier in respect of the supply of goods or services or both at the time of, or before delivery of goods or supply of services;

[..]"

Accordingly, it can be said GST is leviable on the supply of goods or services or both, on the value as determined under section 15. Further that, the value of any taxable supply is to be arrived at by adding the value of other 'connected and incidental activities/supplies' which in under ordinary circumstance would be added to the value.

In this connection, Schedule II to the CGST Act states that specific activities shall be treated as a supply of goods or supply of services, for instance:

"[…]

- *'construction of a complex, building, civil structure or a part thereof, including a complex or building intended for sale to a buyer, wholly or partly, except where the entire consideration has been received after issuance of completion certificate, where required, by the competent authority or after its first occupation, whichever is earlier' and*
- *composite supplies such as 'works contract as defined in clause (119) of section 2'.*

[…]"

Old controversies resolved?

While it seems that GST has put to rest all the old issues such as disputes arising from the classification of transactions into one for goods or services or both, and the need for value shifting, etc., but there is enough reason to suspect that the Government has changed the goal posts once again, because now the taxable supply and valuation thereof is on the following basis:

- Supply of goods or services is taxable if such supply is made for a consideration
- Such supply is in the course of or furtherance of business
- Such consideration may be in money or money worth in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person
- Value of supply shall include any amount that the supplier is liable to pay in relation to such supply but which has been incurred by the recipient of the supply and not included in the price actually paid or payable for the goods or services or both

While on one end, the Government has simplified things by providing in Schedule II of the CGST Act that construction of a civil structure, etc shall be treated as a composite supply and a service (notwithstanding what is provided in Article 366(29A)) on the other hand the Government has ensured (by virtue of Section 15) that ancillary and connected supplies are included in the value of supply and at the same time defined the term 'consideration' very widely to cover in its scope not only payments in any form made in response to/ for the inducement of supply. Both the terms have a very wide import, further payment may be made by the recipient or any other person are sufficient to trigger liability under GST.

One may even ask what the rationale behind such a wide coverage is? Further, considering that GST is a tax on the value added and that all supplies whether in the form of goods or services or both have already been brought under its ambit and taxed is there a need for the ambit to be spread so wide.

If one reads Section 7 on a standalone basis he can argue that since a supply of free issue material such as steel and cement are being supplied without any consideration and therefore outside the ambit of 'supply' as defined under Section 7. However, the worry is that one needs to read Section 7 along with the valuation provisions under Section 15 which provide the value of supply (contract value) shall be enhanced *any amount that the supplier is liable to pay in relation to such supply but which has been incurred by the recipient of the supply and not included in the price actually paid or payable for the goods or services or both. To further complicate this the term 'consideration' now covers any payment made or to be made whether in money or not, in respect of, in response to, or for the inducement of, the supply of goods or services or both, whether by the recipient or by any other person.'*

The fear is that there is danger lurking around the corner and that this time the taxpayer will not be able to take the benefit of the Supreme Court's ruling in the case of Bhayana Builders (refer aforesaid)

Supplies during warranty period:
In today's marketplace, most of the goods sold come with a warranty provided by the manufacturer. Terms of sale in many of the cases provide that if the goods develop a defect or do not deliver a certain (pre-agreed) level of performance or if some of the parts of the goods develop a defect within a certain period then the manufacturer will provide a free replacement. Such replacement generally entails taking back the defective goods/parts and supplying/ replacing/ exchanging the same for new/fresh goods (in a working condition). The pertinent question is that whether such a supply/replacement/exchange constitutes supply for the purpose of GST and whether the same can be brought to tax in absence of any consideration.

The primary issue is whether goods replaced under warranty fall within the scope of 'supply' considering that it *inter alia* includes *exchange, barter*. The majority view is *'No such a supply does not constitute an exchange or barter, or for that matter supply since there is no consideration'*. But that's half of the story if one were to approach the issue from a contract law or a sale of goods related law perspective the legal position and conclusions would leave no room for doubt that warranty supplies are clearly out of the scope of taxable supply.

Claiming Input Tax credit
Section 17(5)(h) provides that input tax credit will be blocked in case of **goods lost, stolen, destroyed, written off** or **disposed of by way of gift or free samples** - the operative words being 'disposed of by way of gift or free sample'. Pre-GST the era of 'BOGO – Buy One Get One' free was a very popular marketing scheme and a sure shot winner for several businesses. But post-GST, BOGO offers have all but disappeared. One primary reason behind the disappearance of BOGO offers is Section 17(5)(h). But the question that one needs to assess is whether BOGO offers fall within the realm of 'gift' or 'free samples'.

Similarly, in case of warranty supplies – it is generally understood that the supply is not (realistically speaking) free given the fact that manufacturer builds the cost of the free replacement into the cost and recovers the same at the time of sale. In the past, this argument has been successfully argued under the Central Excise regime. As a matter of fact, the CBIC in its FAQs have clarified:

> *19 What would be the tax liability on replacement of parts (no consideration is charged from a customer) under a warranty and whether the supplier is required to reverse the input tax credit?*
>
> ***As parts are provided to the customer without a consideration under warranty, no GST is chargeable on such replacement. The value of supply made earlier includes the charges to be incurred during the warranty period. Therefore, the supplier who has undertaken the warranty replacement is not required to reverse the input tax credit on the parts/components replaced.***
>
> *20 An Original Equipment Manufacturer (OEM) has an obligation to provide repair services to their customers in the warranty period. This activity is outsourced by OEM to 'D', who bills the OEM for the services he provides to the customer. What is the tax liability of 'D'?*
>
> *'D' is providing service to the OEM. GST is payable on the value of any supplies made by 'D' to OEM i.e. in respect of bills raised by 'D' on the OEM.*

At least on this issue, hopefully, there will be no debate or dispute.

Conclusion
The above write up is just a trailer of some of the underlying issues, one can be assured that there are several other issues which are likely to come up in the foreseeable future and that journey forward will be not only interesting but full of action (from the Government's side).

❍❑❍

 

CA Ashit Shah and CA Kush Vora

INDIRECT TAXES
GST – Legal Update

The authors have tried to cover GST updates pertaining to law points in particular. The notifications, circulars, orders relating to extension of various statutory due dates are not covered herewith.

A. Central Goods & Services Tax (CGST)

1. **Amendment to GST Rules** – Thirteenth Amendment Rules (Notification No. 26 /2018 dated 13-6-2018 & 28/2018 – dated 19-6-2018)

    a. Goods and Service Tax Practitioners have to pass the examination within a period of 18 months substituted for 12 months. [Rule 83 (3)]

    b. Net ITC and Adjusted Total Turnover specifically defined for claiming refund of inverted duty structure with retrospective effect from 1st July 2017 by amending Rule 89 (5) of CGST Rules, 2017.

    c. E-way bill should not be generated where empty cylinders for packing of liquefied petroleum gas are being moved for reasons other than supply. [Rule 138 (14) (o)]

    d. Following forms were amended to certain extent viz. FORM GSTR-4, FORM GST PCT-01 (with retrospective effect from 1-7-2017), GST RFD-01, GST RFD-01A.

    e. Transporters who are not registered under GST have to apply for Unique Enrolment Number in Form GST ENR-01. It is now provided that transporters who are operating in more than one State or Union Territory have to obtain unique common enrolment form in Form GST ENR-02. [Rule 58]

    f. A summary report of every inspection of goods in transit shall be recorded online by the proper officer in Part A of FORM GST EWB-03 within twenty four hours of inspection and the final report in Part B of FORM GST EWB-03 shall be recorded within three days of such inspection.

    Proviso is inserted to extend the time limit for recording final report in Part B of Form EWB-03 for a further period not exceeding

3 days. Further, period of 24 hours or, as the case may be, 3 days shall be counted from the midnight of the date on which the vehicle was intercepted.";

B. NOTIFICATIONS

S.67 provides power for inspection, search and seizure of goods or any documents or books or things. Now power had been granted to dispose of certain goods having characteristics of perishable or hazardous nature or depreciated in value with the passage of time, constraint in storage space etc.

1. Notification No. 27/2018 – Central Tax – dated 13-6-2018

Provisions of TDS, TCS and Tax payable on procurement of goods or services from unregistered persons under Reverse Charge Mechanism

Date of exemptions in respect of TDS, TCS and tax payable on procurement of goods or services or both, from unregistered persons under Reverse Charge Mechanism has been extended from 30th June 2018 to a further period of 3 months i.e. 30th September 2018.

2. Notification No. 12/2018 – Central Tax (Rate) – dated 29-6-2018

C. CIRCULARS

1. Circular No. 46/20/2018 – GST – Dated 6-6-2018

Board had clarified the applicability of GST on Priority Sector Lending Certificates (PSLCs), Renewable Energy Certificates (RECs) and other similar scrips. Renewable Energy Certificates (RECs) and Priority Sector Lending Certificates (PSLCs) and other similar documents are classifiable under Heading 4907 and attract 12% GST. The duty credit scrips, however, attract Nil GST under S. No. 122A of Notification No. 2/2017-Central Tax (Rate) dated 28-6-2017.

2. Circular No. 47/21/2018 – GST – Dated 8-6-2018

Certain issues were clarified by Board on applicability of GST as under-

Sr. No.	Issue	Clarification
1.	Whether moulds and dies owned by Original Equipment Manufacturers (OEM) that are sent free of cost (FOC) to a component manufacturer is leviable to tax and whether OEMs are required to reverse input tax credit in this case?	• There is no requirement for reversal of input tax credit availed on such moulds and dies by the OEM. • Value of the supply made by the component manufacturer, the value of moulds and dies provided by the OEM to the component manufacturer on FOC basis shall not be added to the value of such supply.
2	Servicing of cars involving both supply of goods (spare parts) and services (labour), where the value of goods and services are shown separately, to be treated under GST?	• Where a supply involves supply of both goods and services and the value of such goods and services supplied are shown separately, the goods and services would be liable to tax at the rates as applicable to such goods and services separately.

Sr. No.	Issue	Clarification
3	Auction of tea, coffee, rubber etc., whether the books of account are required to be maintained at every place of business by the principal and the auctioneer, and whether they are eligible to avail input tax credit?	• For the purpose of auction of tea, coffee, rubber, etc., the principal and the auctioneer may declare the warehouses, where such goods are stored, as their additional place of business. The buyer is also required to disclose such warehouse as his additional place of business if he wants to store the goods purchased through auction in such warehouses. • It is further clarified that the principal and the auctioneer for the purpose of auction of tea, coffee, rubber etc., or the principal and the auctioneer for the purpose of supply of tea through a private treaty, shall be eligible to avail input tax credit subject to the fulfilment of other provisions of the CGST Act read with the rules made thereunder.
4	In case of transportation of goods by railways, whether goods can be delivered even if the e-way bill is not produced at the time of delivery?	As per proviso to rule 138(2A) of the Central Goods and Services Tax Rules, 2017 (CGST Rules for short), the railways shall not deliver the goods unless the e-way bill is produced at the time of delivery.
5	Whether e-way bill is required in the following cases- (i) Where goods transit through another State while moving from one area in a State to another area in the same State. (ii) Where goods move from a DTA unit to a SEZ unit or vice versa located in the same State.	• If the goods transit through a second State while moving from one place in a State to another place in the same State, an e-way bill is required to be generated • Where goods move from a DTA unit to a SEZ unit or *vice versa* located in the same State, there is no requirement to generate an e-way bill, if the same has been exempted under Rule 138(14)(d) of the CGST Rules.

3. Circular No. 48/22/2018 – GST – dated 14-06-2018

Clarifying miscellaneous issues related to SEZ and refund of unutilized ITC for job workers:

Sr. No.	Issues	Clarification
1	Whether services of short-term accommodation, conferencing, banqueting etc. provided to a Special Economic Zone (SEZ) developer or a SEZ unit should be treated as an inter-State supply (under section 7(5)(b) of the IGST Act, 2017) or an intra-State supply (under section 12(3)(c) of the IGST Act, 2017)?	• It is an established principle of interpretation of statutes that in case of an apparent conflict between two provisions, the specific provision shall prevail over the general provision. • S. 7(5)(b) of the IGST Act is a specific provision relating to supplies of goods or services or both made to a SEZ developer or a SEZ unit, which states that such supplies shall be treated as inter-State supplies. • It is clarified that services of short term accommodation, conferencing, banqueting etc., provided to a SEZ developer or a SEZ unit shall be treated as an inter-State supply.
2	Whether independent fabric processors (job workers) in the textile sector supplying job work services are eligible for refund of unutilised input tax credit on account of inverted duty structure under section 54(3) of the CGST Act, 2017, even if the goods (fabrics) supplied are covered under notification No. 5/2017-Central Tax (Rate) dated 28-6-2017?	• N. No. 5/2017 – Central Tax (Rate) dated 28-6-2017 specifies the goods in respect of which refund of unutilised input tax credit (ITC) on account of inverted duty structure u/s. 54(3) of the CGST Act shall not be allowed where the credit has accumulated on account of rate of tax on inputs being higher than the rate of tax on output supplies of such goods. • However, in case of fabric processors, the output supply is the supply of job work services and not of goods (fabrics). • Hence, it is clarified that the fabric processors shall be eligible for refund of unutilised ITC on account of inverted duty structure under section 54(3) of the CGST Act even if the goods (fabrics) supplied to them are covered under Notification No. 5/2017-Central Tax (Rate) dated 28-6-2017

ML-861

CA Naresh Sheth & CA Piyush Jain

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Decisions in respect of Writ, Special Leave Petition and other grievances

1. *Modern Traders vs. State of U.P. (2018-TIOL-48-HC-ALL-GST)*

Facts, Issue involved and Contention of Petitioner:

Petitioner is engaged in business of Iron and Steel. Petitioner sold goods to a registered company against the Invoice No. 0003 dated 5-4-2018 after charging IGST @ 18%. Goods were loaded by transporter in vehicle No. UP 13 AT 1153 on 4-5-2018. As notification issued under CGST/UPGST Act were silent with regard to requirement of e-Way bill for inter-State transactions, petitioner dispatched the goods without generating the e-Way bill.

During movement of vehicle, it was intercepted by Assistant Commissioner, State Tax, Mobile Squad, Unit-II, Noida at 1:30 a.m. on 5-5-2018 solely on the ground that goods were not accompanied with e-Way bill. Assistant Commissioner proceeded for inspection/physical verification of goods and for same he has issued verification report in part-A and part-B on 5-5-2018 wherein no time has been mentioned. When petitioner's firm received information about interception of vehicle, they immediately generated e-Way bill on 5-5-2018 at 11.55 a.m. and tried to contact Assistant Commissioner. However, petitioner was informed that Assistant Commissioner will be available after 2 p.m. and thereafter at 2.30 p.m. the aforesaid e-Way bill was furnished.

Petitioner has submitted that goods were intercepted at 1:30 a.m. on 5-5-2018 whereas the e-Way bill was generated on the same day at 11.55 a.m. which was furnished before Assistant Commissioner but reasons best known to the Assistant Commissioner, seizure order and consequential penalty order has been passed. Petitioner has submitted that once e-Way bill was generated after interception of goods, but before seizure order is passed, then goods cannot be seized as is held by this Court in the case of Express Logistics India Pvt. Ltd. Petitioner has also relied upon Circular 41/15/2018-GST dated 13-4-2018 issued by CBEC distinguishing between interception and detention. Since petitioner has furnished the e-Way bill prior to detention and seizure of goods, no seizure order can legally be passed nor penalty can be asked.

Held

While issuing the interception memo, Assistant Commissioner has mentioned the time being

1.30 a.m. on 5-5-2018 and directed the petitioner to appear on 6-5-2018 at 10 a.m. for physical verification, however while preparing the verification record (Part-A and Part-B) no time has been mentioned.

Petitioner has also brought to our notice that the Assistant Commissioner, with malice intention, has deliberately not mentioned the time in either of the orders passed being the seizure order u/s. 129(1) and penalty u/s. 129(3). Both the aforesaid orders are passed on 5-5-2018 i.e., before the date which has been indicated in the interception memo being 6-5-2018. Petitioner has submitted that since it has placed the e-Way bill on 5-5-2018 itself, Assistant Commissioner has illegally proceeded to pass the impugned orders before any physical verification done.

We find substance in the submission of the petitioner. Once the e-Way bill is produced and other documents clearly indicates that the goods belong to the registered dealer and the IGST has been charged there remains no justification in detaining and seizing the goods and asking the penalty.

In view of the aforesaid facts, Court quashed the seizure order dated 5-5-2018 as well as the consequential penalty order dated 5-5-2018. Court directed the Assistant Commissioner to immediately release the goods and vehicle in favour of the petitioner.

B. Rulings by Authority on Advance Rulings

2. TP Ajmer Distribution Limited – AAR Rajasthan (2018-TIOL-77-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is engaged in the business of distribution of electricity. Applicant is responsible for operating and maintaining the distribution network in Ajmer city. Applicant is also responsible for managing billing and collections in Ajmer City.

Applicant carries out various activities and makes separate recoveries from its customers in order to distribute electricity. Aforesaid non-tariff charges are fixed and recovered from customers in accordance with provisions of Electricity Act, 2003 and regulations made in this behalf by Rajasthan Electricity Regulatory Commission ('RERC').

Applicant also submitted that under GST regime, as per Entry No. 25 of Notification No. 12/2017 – Central Tax (Rate) dated 28-6-2017, exemption from levy of GST has been granted to the activity of 'Transmission or distribution of electricity by an electricity transmission or distribution utility'.

Applicant has sought following clarifications:

(a) Whether it is eligible to avail the exemption from levy of GST under Entry No. 25 of Notification No. 12/2017 – Central Tax (Rate) dated 28-6-2017 with respect to non-tariff charges recovered from its customers?

(b) Whether it is liable to pay tax on aforesaid recovery made from its customers?

Discussions by and Observations of AAR

Serial 2(z) of Notification No. 12/2017-Central Tax (Rate) dated 28-6-2017 (hereinafter referred to as 'Exemption Notification') defines electricity transmission or distribution utility as under:

"Electricity transmission or distribution utility" means the Central Electricity Authority; a State Electricity Board; the Central Transmission Utility or a State Transmission Utility notified under the Electricity Act, 2003 (36 of 2003); or a distribution or transmission licensee under the said Act, or any other entity entrusted with such function by the Central Government or, as the case may be, the State Government".

Applicant is regarded as a franchisee since it has entered into Distribution Franchisee Agreement ('DFA') with Ajmer Vidyut Vitran Nigam Limited ('AVVNL') under the Electricity Act, 2003. Therefore, applicant clearly falls within the ambit of definition of the term 'electricity transmission or distribution utility' and transmission or distribution of electricity is exempted.

As regards other services provided by applicant, it is clarified by the Department under Serial No. 4 of Circular No. 34/8/2018-GST dated 1-3-2018 issued *vide* F. No. 354/17/2018 as under:

Issue	*Clarification*
(1) Whether the activities carried by DISCOMS (Distribution Companies) against recovery of charges from consumers under State Electricity Act are exempt from GST?	*(1) Service by way of transmission or distribution of electricity by an electricity transmission or distribution utility is exempt from GST under notification No. 12/2017-CT(R), Sl. No. 25. The other services such as,* *i. Application fee for releasing connection of electricity;* *ii. Rental Charges against metering equipment;* *iii. Testing fee for meters/transformers, capacitors etc.;* *iv. Labour charges from customers for shifting of meters or shifting of service lines;* *v. Charges for duplicate bill;* *Provided by DISCOMS to consumer are taxable.*

Therefore, in view of clarification issued under Circular No. 34/8/2018-GST dated 1-3-2018 issued *vide* F. No. 354/17/2018, it is found that applicant is not eligible to avail exemption from levy of GST under Entry No. 25 of exemption notification with respect to the non-tariff charges recovered from their customers and is liable to pay tax on aforesaid recovery made from its customers.

Ruling of AAR

In light of clarification issued under Circular No. 34/8/2018-GST dated 1-3-2018 issued *vide* F. No. 354/17/2018-TRU and provisions of GST Act, non-tariff charges recovered from customers are not eligible for exemption and applicant is liable to pay tax on aforesaid recovery made from their customers.

3. IT Development Agency (ITDA), Government of Uttarakhand, Dehradun – AAR Uttarakhand (2018-TIOL-78-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is registered under the Society Registration Act, 1860 and it is under administrative control of Information Technology Department of Uttarakhand Government. Hon'ble Governor has nominated the applicant as State Nodal Organisation. Applicant's executive committee consists of Government Officers.

Applicant has submitted an MOU with IIT, Mumbai which relates to design, development and field testing of "Aerostat Based Last Mile Communication System".

Applicant has requested for advance ruling on leviability of GST on procurement of services or material from Government/Government Authority (i.e. IIT, Mumbai).

Discussions by and Observations of AAR

As per definition of Government provided in section 2(53) of the Uttarakhand Goods and Services Tax Act, 2017, "Government" means the Government of Uttarakhand. Further, as per section 2(69)(c) of Uttarakhand Goods and Services Tax Act, 2017, "local authority" means a Municipal Committee, a Zilla Parishad, a District Board and any other authority entitled to or entrusted by a Central Government or any State Government with the control or management of a municipal or local fund. Thus, Applicant is a local authority under Uttarakhand Government.

To determine status of IIT, Mumbai, the AAR finds that the Indian Institute of Technology (IITs) are autonomous public institutes of higher education located in India. They are governed by the Institutes of Technology Act, 1961 which has declared them as institution of national importance and lays down their powers, duties, and framework for governance etc. The President of India is the most powerful person in the organisational structure of IITs, being the *ex officio* visitor and having residual powers. The amendments in the Institutes of Technology Act, 1961 is to be made by the Parliament. Thus, IIT, Mumbai falls under the definition of Government in terms of Section 2(53) of the Central Goods and Services Tax Act, 2017 wherein "Government" means the Central Government.

In view of above, AAR finds that applicant is covered under local authority which is receiving services from IIT, Mumbai which is covered as Central Government. Serial No. B of Part 3 of GST Tariff – Services [Chapter 99] provides the list of nil rated/fully exempted services. On going through the list, Government/authority providing services to other Government/ authority is exempted from GST.

Ruling of AAR
Services received by applicant from IIT, Mumbai is exempted from GST. As regards to supply of goods by one Government/authority to other Government/authority is concerned, the AAR find that there is no exemption from GST in this regard.

4. BASF India Limited – AAR Maharashtra (2018-TIOL-82-AAR-GST)

Facts, Issue involved and Query of Applicant:
Applicant is engaged in trading of chemicals and allied products. Applicant will be buying products at arm's length price from overseas related supplier. Such product shall be bought against purchase orders received from applicant's customers (i.e., back-to-back purchase orders). Overseas supplier will export the products and the export documents such as bill of lading will show applicant as buyer of goods.

Before goods cross the customs frontier of India, applicant will sell the goods to its customer who was identified at time of placing order on overseas related party. Sale will be effected by executing an agreement of sale (known as High Seas Sale agreement) and by endorsing the bill of lading in name of end customer. The Import General Manifest ('IGM') will be filed in name of the end customer by shipping line. Thereafter, bill of entry will be filed by end customer who will discharge applicable duties of customs and IGST on imported goods. In trade parlance, the transaction as proposed above, is commonly referred to as a 'High Seas Sale transaction'.

Applicant seeks clarification on following questions:

(a) Whether IGST will be leviable on High Seas Sale effected by applicant to customers who are known to them at time of placing order on oversea party?

(b) Whether input tax credit will have to be reversed, to extent of inputs, input services and common input services used by applicant, in case above transaction is not subject to levy of GST by treating the same as exempt supply for purpose of Section 17 of CGST Act?

Discussions by and Observations of AAR:
Section 7(2) of the IGST Act, 2017 reads as *"Supply of goods imported into the territory of India, till they cross the customs frontier of India, shall be treated to be supply of goods in the course of inter-State trade or commerce"*. From the proposed transaction placed by applicant before AAR, there is no iota of doubt that goods of the applicant are imported goods and when applicant is selling these goods on High Seas

Sale basis, these goods have not crossed the customs frontier of India. Thus, the transaction in these goods are in nature of inter-State supply as per section 7(2) of IGST Act, 2017.

As per proviso to Section 5(1) of IGST Act, 2017, IGST on goods imported into India is to be levied and collected in accordance with section 12 of the Customs Act, 1962 and section 3 of the Customs Tariff Act, 1975. Section 12 of the Customs Act, 1962 provide that custom duties which include IGST in respect of imported goods would be levied only at time of import or export of goods. Thus in case of goods sold on High Seas Sale basis, there is no levy till the time of their custom clearance. In view of this, import goods sold on High Seas basis would come in category of 'exempt supply' as no duty is leviable on them except in accordance with proviso to Section 5(1) of the IGST Act, 2017.

As per Section 2(47) of CGST Act, 2017, "exempt supply" means supply of any goods or services or both which attracts nil rate of tax or which may be wholly exempt from tax u/s. 11 or u/s. 6 of IGST Act, 2017 and includes non-taxable supply".

As per Section 2(78) of CGST Act, 2017, "non-taxable supply" means a supply of goods or services or both which is not leviable to tax under this Act or under the IGST Act.

Thus, it is clear that goods which are sold on high sea sale basis are non-taxable supply as no tax is leviable on them till the time of custom clearance in accordance with and compliance of Section 12 of the Customs Act, 1962 and Section 3 of the Customs Tariff Act, 1975. The goods sold on High Seas Sale basis being non-taxable supply u/s. 2(78) of CGST Act and being exempt supply u/s. 2(47) of CGST Act, the input tax credit to extent of inputs, input services and common input services would be required to be reversed by applicant as per Section 17 of CGST Act.

Ruling of AAR

In case of goods sold on High Seas Sale basis, there is no levy till the time of their Customs clearance in compliance with Section 12 of the Customs Act, 1962 and Section 3 of the Customs Tariff Act, 1975.

Goods sold on High Seas Sale basis being non-taxable supply u/s. 2(78) of CGST Act and being exempt supply u/s. 2(47) of CGST Act, the input tax credit to extent of inputs, input services and common input services would be required to be reversed by applicant as per Section 17 of CGST Act.

5. Five Star Shipping – AAR Maharashtra (2018-TIOL-83-AAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is a firm engaged in providing following service:

i. Principal service of collecting marketing intelligence and updates which is disbursed to ship owners (i.e., consultancy services);

ii. Ancillary service of providing support service to Indian/foreign ship owners to identify charterers outside India and monitoring voyage execution.

Consultancy service and support service provided by applicant is generally referred to as Marine Consultancy Service (MCS). Applicant provides MCS in terms of a Consultancy Agreement executed by and between applicant and ship owners. Fees for such service is fixed pre-hand and typically is percentage of gross revenue earned by India/foreign ship owner. Applicant is clear regarding GST implication on service provided to Indian ship owners as both provider and recipient of service are located in India. However, there is inadequate clarity regarding GST implications on services provided to foreign ship owners and hence applicant has sought advance ruling in respect of following issues:

(a) Whether MCS supplied is 'composite supply' with consultancy service as principal supply and not a 'mixed supply'?

(b) Whether consultancy service will qualify as business consultancy service in terms of scheme of classification of service [Annexure to Notification 11/2017-Central Tax (Rate) dated 28-6-2018]?

(c) Whether support services qualifies as 'intermediary service' in term of section 2(13) of IGST Act, 2017?

Discussions by and Observations of AAR

Composite Supply is defined u/s. 2(30) of the CGST Act, 2017 as *"composite supply" means a supply made by a taxable person to a recipient consisting of two or more taxable supplies of goods or services or both, or any combination thereof, which are naturally bundled and supplied in conjunction with each other in the ordinary course of business, one of which is a principal supply;"*. It can be seen that a composite supply consist of:

- Two or more taxable supplies of goods or services or both, or any combination thereof;
- These taxable supplies are naturally bundled;
- These taxable supplies are supplied in conjunction with each other in the ordinary course of business;
- One of these taxable supplies is a principal supply.

As per sample agreement submitted by applicant, it says that foreign ship owner appoints applicant as consultant and technical advisor to perform consulting service specifically set out in the exhibit of the agreement. From the scope of work as set out in exhibit of the agreement, consulting and technical services have been specifically set out. There is a clear understanding that foreign ship owner will request consultancy service on as-needed basis. It is expressly provided that foreign ship owner may elect to have any of the services performed by other consultants or foreign ship owner's staff. Hence there is no doubt that the services are not needed to have been bundled together. Each service can be provided in isolation in terms of convenience of foreign ship owner, there cannot be identified any service which could be said to be principal supply. In view of specific facts from the agreement, AAR has concluded that the provision of service would not be a composite supply under the GST Act.

Relevant annexure about scheme of classification of services as appended to Notification No. 11/2017-Central Tax (Rate) is reproduced as under:

S. No.	Chapter, Section, Heading, Group	Service Code (Tariff)	Service Description
297	99831		Management consulting and management service; information technology services
299		998312	Business consulting services including public relations service

Business consultancy services are covered under the group 'Management consulting and management service'. General understanding of term 'Management Consultancy' is that it is a practice of keeping organisations to improve their performance, operating primarily through analysis of existing organisational problems and development of plans for improvement. Consultancies may also provide organisational change management assistance, development of coaching skills, process analysis, technology implementation strategy development or operational improvement services. In present case, it is apparent that consultancy services provided by applicant are not in nature of guiding ship owning company in management of ship owning. Consultancy service provided by applicant are in nature of consultancy in respect of opportunities of marine transport business, which is one of the support service in respect of marine transport. Therefore, such services are required to be classified under support service in transport. In case applicant are providing other professional, technical and business service or other support service, then applicant will have to classify their services after taking into consideration exact nature of service.

"Intermediary service" is defined u/s. 2(13) of IGST Act, 2017 as *"intermediary" means a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or both, or securities, between two or more persons, but does not include a person who supplies such goods or services or both or securities on his own account".* An intermediary is to arrange or facilitate supply of services between two or more persons. As visible from terms of agreement from sample copy submitted to AAR, the applicant would be covered in definition of intermediary in terms of Section 2(13) of IGST Act, 2017.

Ruling of AAR:
Marine Consultancy Services provided to foreign ship owners does not constitute 'composite supply' in terms of Section 2(30) of the CGST Act, 2017.

Consultancy Service will not qualify as business consultancy service in terms of scheme of classification of services [Annexure to Notification No. 11/2017-Central Tax (Rate) dated 28th June, 2017].

Support services qualifies as 'intermediary service' in terms of section 2(13) of IGST Act, 2017.

6. Zaver Shankarlal Bhanushali – AAR Maharashtra (2018-TIOL-84-AAR-GST)

Facts, Issue involved and Query of Applicant
Applicant is a tenant of second floor of a commercial building. M/s. Future Communications Limited (owner of plot of land) have entered into agreement with M/s. Spenta Residency Private Limited (the developer) to develop new building in place of new building. Thereby, they entered into an agreement with applicant (tenant) for new premises to be allotted in lieu of giving up possession of old premises. Owner is to provide applicant with a permanent alternate accommodation in the new building to be constructed by developers.

It has been agreed with the developers and owners that during the construction period, applicant is to make own arrangements for accommodation and the owner or developer will pay an amount of ₹ 2,05,000/- per month as compensation for alternate accommodation. If construction period extends beyond 2 years, compensation for alternate accommodation will increase to ₹ 2,25,000/- per month for first 6 months (grace period) and ₹ 2,47,000/- per month for further 6 months (additional grace period). In case construction period goes beyond original period of 2 years plus total grace period of 1 year, developer/owner are liable to pay amount of ₹ 5,00,000/- per month as compensation for alternate accommodation/damages for delayed handover of possession.

Applicant has sought advance ruling on the issues that whether GST is applicable on following compensation to be paid by developer/owner to applicant:

(a) Compensation for alternate accommodation for first 36 months;

(b) Damages for delayed handover of possession of new premises after the period of 36 months.

Discussions by and Observations of AAR
Section 9 of the CGST Act provides that there will be levied a tax on supplies of goods or services or both. Supply is defined u/s. 7 of the CGST Act. As per Section 7(1)(d), supply includes activities to be treated as supply of goods or supply of services as referred to in Schedule II. Clause 5(e) of Schedule II defines

[Contd... on page 202]

ML-868

CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018-TIOL-1888- CESTAT MUMBAI

Case: ***HOLTEC ASIA PVT. LTD. vs. CCE, Pune-I***

Background facts of the case

The appellants are rendering "Consulting Engineer Services" to its parent company, M/S. HOLTEC INTERNATIONAL, USA. In terms of notification 27/2012-CE(NT) dated 18th June, 2012, they filed refund claim of CENVAT credit u/r. 5 of CCR, 2004.

The parent company has set up a project office in Pune, India who was rendering services solely to M/s. NTPC for their Thermal project, contract which was received from M/s. BGR Energy Systems Ltd. The said project office had obtained service tax registration at Wakad, Pune.

It was claim of the adjudicating authority that in view of the definition of 'Service recipient' u/r. 2(i) of PPSR, 2012 the location of service recipient is premises for which such registration has been obtained i.e., India. Since the appellants and the parent company are located in India, the place of provision of service shall be the location of service recipient of service in view of Rule 8 of PPSR, 2012. Accordingly, conditions (b) i.e., the recipient of service is located outside India and (d) i.e., the place of provision of service is outside India, of Rule 6A of STR, 1994 as regards "export of service" are not satisfied.

The adjudicating authority rejected the refund claim of the appellants on the above ground. Hence, the present appeal is filed.

Arguments put forth

The Appellants submitted as under:

a) They are providing engineering, design and drawing services to their parent company i.e. HOLTEC International, USA and receiving the consideration in foreign exchange therefore their service qualify as export and are entitled for refund.

b) The recipient of service is the person who has contracted to avail the services and who is obliged to make payment for the services. Reliance placed on ***Paul Merchant Ltd - 2012-TIOL-1877-CESTAT-DEL, Microsoft Corporation India Pvt. Ltd. - 2014-TIOL-1964-CESTAT-DEL.***

c) The registration of HOLTECH International USA project office in India with the service tax department shall not have any bearing on the services provided by Appellant to HOLTECH International, USA and will continue to qualify as Export of service. As per the RBI Regulations, any project office is opened for the specific purpose only and cannot carry out any other business other than the purpose of which RBI has given permission to open the project office.

d) The Appellant does not have any role with respect to the said Project office and has neither provided any service in relation to or to be consumed by the said project office. The reliance on Rule 2(i)(a) of the Place of Provision of Service Rules, 2012 (POPS Rules') is misplaced.

e) The establishment of HOLTEC International in India and USA shall be treated as distinct persons in view of explanation 3(b) of Section 65B(44). Analogy can also be drawn from Section 66A that where the provider of service has his establishment in two countries, the country where the establishment of the service provider is directly concerned with the provision of service is located, shall be treated as the country from which the service is provided. Thus in present case the establishment located in USA who has contracted for the service and not the project office will be considered as recipient of service. Therefore service provided by the Appellant will qualify as export of service.

f) Even if it is assumed that services was being used in two locations, then as per Rule 2(i)(b)(iii) where services are used at more than one establishment, the establishment most directly concerned with the use of the services will be considered as the recipient of service.

The Respondent reiterated the submissions of the impugned O-I-O.

Decision

a) The interpretation of adjudicating authority that in terms of provisions of Rule 2(i) of PPS Rules the location of the service recipient automatically becomes the 'premises for which service tax registration" is obtained and once the recipient is not located outside India, the vital condition of the Rule 6A(1) of service tax rules is not satisfied, cannot be accepted.

b) The place of provision of service rules cannot be applied to the refund being claimed in terms of Rule 5 of CENVAT Credit Rules and to interpret the export of service

c) In the present case the services were rendered to service recipient who is located outside India. The Indian Project office of M/s. HOLTECH International Ltd, USA was not at all concerned with such services. Further in terms of Explanation 3 to Section 65B(44) different establishment located in non taxable territory and taxable territory are to be treated as establishment of different persons.

d) The appeal was allowed by granting claim of refund.

Citation: 2018-VIL-454-CESTAT-DEL-ST

Case: Larsen & Toubro Limited and Pawan Engineering Works vs. CCE Raipur

Background facts of the case

Appellant M/s. Pawan Engineering Works are the service providers of services like erection, commissioning and installation to M/s. Larsen & Toubro (L & T) who are registered with the appropriate Service Tax Authorities. However the intelligence was gathered that the appellants have not got themselves registered, despite they were providing the taxable services. Resultantly, summons was issued to the principal - Larsen & Toubro Ltd., Appellant and the Appellant's contractor by the Preventive Office of Central Excise. In furtherance of the statements recorded, since L & T has shared the responsibility of the Appellant, as far as the payment of service tax is concerned, show cause notice was served upon both of them.

Arguments put forth

The Appellants submitted as under:

g) The Show Cause Notice is raised by the Commissioner, Raipur, while the work in question was executed in the States of Orissa, Bihar and West Bengal i.e. outside the geographical limits of Raipur jurisdiction and accordingly the SCN is not within the jurisdictional boundaries of person issuing SCN.

h) The activity carried out by the appellant is mostly in nature of fabrication, as they being the sub-contractor, were asked to fabricate/manufacture a stool irrespective the said stool was to be fixed to a structure to be fastened to earth but the activity of the appellant cannot be classified as that of erection, commissioning and installation but was purely a manufacture.

i) It was impressed upon that whatever is the liability the same has already been paid by the principal i.e. M/s. L & T on the overall product as is apparent from their affidavit tendered before the competent authority and also the pleadings on their behalf. Tax once paid, no further liability remains for the appellant/ the sub-contractor to be discharged further.

j) The SCN is alleged as being hopefully barred by time as Department had no justified reason to invoke the extended period

The Respondent submitted as under:

a) The Head Office of the appellant is situated in Raipur; as a result, Commissionerate of Raipur was very well competent to issue a show cause notice to the appellant.

b) The fabrication of stool as is impressed upon by the appellant will not classify the appellant's activity as manufacture for the sole reason that the raw-material for the said stool was provided by M/s. Larsen & Toubro itself.

c) Though M/s. Larsen & Toubro has discharged the liability on the gross value of the entire project but, it is impressed upon, that the tax liability of M/s. Larsen & Toubro and that of the appellant/ the sub-contractor are on different transactions and for different services. Hence, the discharge by Larsen & Toubro cannot be considered as discharge of Service Tax liability of the appellant.

d) Finally with respect to the entitlement of invoking the extended period, it is submitted that there is an apparent suppression of fact on part of the proprietor of the Appellant and accordingly extended period is rightly invoked.

Decision

a) The peculiar fact is that in terms of Rule 4 of Service Tax Rules, 1994 no registration was obtained by the petitioner during the relevant period either under Centralised system or under the regional system i.e. at none of different sites in different States, where the works were executed for M/s. Larsen & Toubro Ltd. This peculiar fact makes all the authorities as relied upon by the appellant for the point of jurisdiction, as non-applicable to the facts of the present case. Further, it is an admitted fact that the Appellant is a resident of Raipur within the jurisdiction of Raipur Commissionerate and operates within the domain of that Commissionerate. It is also an admission that all work orders were executed for the appellant at his Raipur's address, and the appellant in furtherance thereof has provided service though at the sites outside the jurisdiction of Raipur. The simultaneous fact also remains is that appellant is not the Site Manager but the service provider only and is based at Raipur with no registration under Service Tax. Thus, the appellants stand for no jurisdiction is not acceptable.

b) To adjudicate upon the argument of manufacture of goods, it is necessary to know as to what the manufacture is. In accordance of Section 2(f) of the Central Excise Act, for an activity to be called as that of manufacturing, it is necessary that a new article should come into existence, as a result of the said activity. The Hon'ble Supreme Court in Hokins Cooker - 1997 (96) ELT 507 (SC) has held that an article even if marketable or deemed marketable would not yet be excisable under Section 3(1)(a) of the Act without passing the pre-mandatory test of manufacture. The definition also clarified that for an activity to be called as manufacture it must satisfy two basic conditions:

o Article should be goods.

o It is marketable.

Section 2 (d) of Finance Act, 2008 defined goods as including any article/material or substitutes, which is capable of being bought and sold for consideration and such goods shall be deemed to be marketable. Decision of Constitution Bench of Hon'ble Supreme Court in the case of *Delhi Cloth and General Mills Co. Ltd. vs. Union of India-1997 (1) ELT 199 (SC) - 1962-VIL-01-SC-CE* has held that for any article to be called as goods, if it is known to be marketed as such and can ordinarily come to the market for being bought and sold, it would fall under the definition of goods and any activity creating such kind of goods will only be called as manufacture. It has also been clarified by Apex Court in the case of *Sipla Ltd. vs. CCE - 2008 (225) ELT 403 (SC) - 2008-VIL-52-SC-CE*. The activity which produces product as must be a distinct commodity known in common parlance to commercial community for the purpose of buying and selling, the activity can be called as manufacture but the activity itself will not be sufficient to prove the marketability.

Applying these principles to the facts of the present case, no doubt *vide* the work order, appellant was asked to fabricate a stool and stool in common parlance is a product known to the market to be sold and purchase. But in the given facts, the stool manufactured by the applicant is admittedly of such specifications of shape and size, which restricts it to be marketable in terms of the common parlance attached to its name. Further, this stool was to be fabricated by the Appellant with the scrap and steel to be provided by M/s. Larsen & Toubro. Admittedly, the appellant had no ownership to the raw-material for the fabrication of stool. Also that stool apparently and admittedly was for enabling mono-rail beam fabrication and thus, was to be fastened to a structure already embedded into the earth. Seen from any of these angles, the stool in the present case falls out of the definition of goods and for the said reason, out of the definition of manufacture in Section 2(f) of Excise Act. On the contrary, the activity of the Appellant is very much covered under the definition of erection, commissioning and installation services Section 65 sub-section 39A of the Finance Act, 1994 specifically under sub-clause (f) thereof and as such, is very much taxable under sub-clause (zzd) of Section 65(105) of the Finance Act as a taxable service.

c) The Bench was of the firm opinion that the liability which has been discharged by M/s. Larsen and Toubro is on the gross value of the entire project. Appellant being one of the service provider admittedly, providing taxable services to Larsen & Toubro and receiving the service charges from them cannot get absolve his liability towards service tax under the pretext of discharge being made by the service recipient. Otherwise also, service tax is to be deposited to the Government not by the recipient but by the provider, who is the appellant in the present case.

d) It is observed that the appellant was running 2 companies including the appellant for providing same kind of services to the same sole recipient and that the company other than the appellant was very much registered under service tax, from no stretch of imagination, it can be presumed that the proprietor was not aware of the services being rendered by the appellant to be the taxable services. Non-registration of the appellant, in the given circumstances, definitely amounts to suppression of relevant fact, which came to the notice of the Department lately only on the basis of some intelligence gathered by the Preventive Officers of Central Excise.

e) Accordingly the appeal filed by the assessee was rejected.

ML-872

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS
Company Law Update

Case Law # 1

[2018] 208 Comp Cas 432 (NCLAT)

[Before the National Company Law Appellate Tribunal – New Delhi]

Quinn Logistics India P. Ltd. v. Mack Soft Tech P. Ltd. and Others

For calculating the time-frame of 180/270 days for the completion of the corporate insolvency resolution process as provided in Section 12 of the Insolvency and Bankruptcy Code, 2016 ("IBC"), on justifiable reason and as allowed by the Adjudicating Authority, the period during which the resolution professional / committee of creditors could not function or was restrained from functioning, shall be excluded

Brief

This appeal has been filed before the National Company Law Appellate Tribunal, New Delhi ("NCLAT") for modification of the order passed by the Adjudicating Authority (National Company Law Tribunal, Hyderabad Bench) ("NCLT). By the said order, NCLT has extended the corporate insolvency resolution process ("CIRP") and directed the Registry to list all pending applications for final hearing on May 15, 2018. However, NCLT has not considered the facts that due to the "interim direction" from NCLT, for 166 days the CIRP could not be processed and no meeting of "committee of creditors" took place. Hence, NCLT should exclude 166 days while counting total period of 270 days for conclusion of CIRP.

The following are the observation of the NCLAT.

1. Section 12 of the IBC provides that CIRP shall be completed within 180 days from the date of admission of application.

2. The said period of 180 days, can be extended to further period not exceeding 90 days, on application for the same and adjudicating authority finds merit thereof.

3. In the present case, NCLT has not held that extension of period is not justifiable.

4. NCLT should have extended the period instead of liquidation, which is the last recourse in case the resolution process fails.

5. Reference of various orders such as in *Amar Remedies Ltd. vs. IDBI Bank Ltd. [2018] 2 Comp Cas-OL 520 (NCLAT)* and *Macquarie Bank Ltd vs. Shilpi Cable Technologies Ltd. [2018] 1 Comp Cas-OL 644 (SC)* were cited. In the case of Macquarie

case, Supreme Court has restored the CIRP with a reason that due to the order passed by the NCLAT, "Resolution Professional" ("RP") could not function.

6. The Adjudicating Authority (Hyderabad Bench,) Kolkata Bench and Ahmedabad Bench have also passed the order which has excluded period during which RP could not function.

Judgment

NCLAT has passed an order directing the Adjudicating Authority to exclude 166 days for the purpose of counting the period for CIRP and allow the RP / committee of creditors further period of 166 days to complete the CIRP.

The NCLAT has provided that following are the good grounds and unforeseen circumstances, where the intervening period can be excluded for counting total period of 270 days to complete the CIRP.

1. If the CIRP is stayed by the Court of Law or by the Adjudicating Authority or by the Appellate Tribunal or the Hon'ble Supreme Court.
2. If RP has not been functioning during the period for reasons such as removal.
3. Period between the date of order of admission / moratorium period and RP takes charge for CIRP.
4. If, the authority as mentioned in (1) above, has initially reserved the order and subsequently passed the final order for enabling the RP to complete the CIRP.
5. Either CIRP set aside or order of Appellate Tribunal is reversed by the Hon'ble Supreme Court, thereby restoring the CIRP.
6. Any other circumstances, which justifies the exclusion of certain period.

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[Contd. from page 196]

"agreeing to the obligation to refrain from an act, or to tolerate an act or a situation, or to do an act" as supply of service.

Applicant has/is to receive compensation from developers for vacating the premises as per the details mentioned in facts of the case. After redevelopment, applicant is to receive newly constructed and redeveloped property for their premises in old building. Thus, the act of vacating premises for facilitating the developer implies that applicant has agreed to do an act and such act of vacating the premises by the applicant squarely falls under clause 5(e) of Schedule II. Therefore, amounts received by applicant for having agreed to do such an act would attract liability.

Receipts of amount towards alternate accommodations or delayed possession of premises would be receipts of doing an act, i.e., vacating the premises for redevelopment as well as tolerating the construction-cum-redevelopment work till possession of new redeveloped premises as per agreement and further tolerating the act of not having the redevelopment work completed within 36 months. In view thereof, same would definitely be a 'supply' under the CGST Act and therefore, there arises an occasion to levy tax under the CGST Act on impugned transactions.

Ruling of AAR

GST is leviable on compensation for alternate accommodation and damages for delayed handover of possession of new premises be paid by developer/owner to applicant.

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Janak C. Pandya, *Company Secretary*

CORPORATE LAWS

Recent Developments

The Companies (Amendment) Act, 2017 – PART II
Major Amendments – Impact & Analysis

The enactment of the Companies Act, 2013 (**"Act"**) which overhauled the erstwhile Companies Act, 1956 has much stringent compliance requirements from all the stakeholders. While the Act was a step in the right direction as it introduced significant changes in areas of disclosures, investor protection, corporate governance, etc., there were multiple issues on interpretation and compliances. To address the stakeholder concern, Government has amended the Act from time-to-time. The Companies Amendment Act, 2017 was notified on 3rd January, 2018.

The summary of some important amendments as set out in the Companies Amendment Act, 2017 are given as below:

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
1.	42 Not yet notified	Issue of shares on private placement basis.	a. The complete section has been substituted. b. Private placement to select group of persons as identified by the Board. c. In a financial year, total number of identified persons to whom private placement of securities can be offered shall not exceed fifty or such higher number as may be prescribed. d. Company can may make more than one issue of securities to identified persons. e. Private Placement offer and application shall not carry right of renunciation.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			f. Companies cannot use funds till return of allotment has been filed with RoC within 15 days from the date of allotment. Separate penalty provided for default in filing of return of allotment. g. New rules are yet to be amended to give effect to the aforesaid amendment, i.e., non-filing with Registrar and SEBI. h. For any non–compliances, penalty is of ₹ 2 crore or amount involved under private placement, whichever is lower.
2.	53(2)	Prohibition on issue of shares at discount.	The amendment has made two changes. In sub-section (2), instead of term "discounted price" it has NOW inserted the term "discount". Thus, bringing more clarity that issue of shares is not to be considered as discounted to any fair or market value but it will NOW be referred as discount to price by referring to nominal value of shares. Due to RBI's directive in case of loan structuring, the creditors or lenders get a right to convert its loan into equity capital of the borrower company. Most of the time, such conversion took place at a discount to face value. However, the Act prohibits such discounts. NOW with this amendments, a new sub-section (2A) has been inserted so to allow company to issue shares at a discount (to nominal value or face value of shares) to its creditors when its debt is converted into shares in pursuance of any statutory resolution plan or debt restructuring scheme in accordance with any guidelines or directions or regulations specified by the Reserve Bank of India under the Reserve Bank of India Act, 1934 or the Banking (Regulation) Act, 1949. However, the provisions does not cover the SARFAESI Act / IBC and if any order under these Acts require such conversion, whether same would be allowed under this provisions is doubtful.
3.	54(1)(c)	Issue of Sweat Equity Shares	Prior to amendment, the company could issue sweat equity only after the completion of one year from its incorporation. However, this restriction of one year, created hurdles for start-ups and tech companies when company is in need of its employee support in its first year of operations by way of technical knowhow etc. against issue of sweat equity.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			NOW one of the conditions in clause (c) of sub-section 1 has been deleted which was requiring a one year period before issuing sweat equity. Thus, removal of the above restriction means a company can issue sweat equity shares before even expiry of 1 year from the commencement of business which in other words sweat equity shares can be issued at any time after incorporation. The above is a positive move for the encouragement of start-ups and technology driven companies.
4.	62(2)	Further issue of Share Capital	NOW, in mode of delivery of offer letter for Right issue under section 62(1)(a)(i) besides speed post, electronic mode, Registered post or courier it has NOW allowed **any other mode having proof of delivery**. Thus, one can even do "hand delivery" of documents. This is a simplified process. For e.g. Under Section 20(2) for service of documents, besides sending documents via post, or by registered post or speed post or courier or electronic mode, it also allows NOW the service of documents on members even by delivering to its office or address or other mode prescribed under Rule 35 of the Companies (Incorporation) Rules 2014. The only requirement for all the above mode of sending documents is to have proof of delivery.
5.	73 (2)(c) Not yet notified	Prohibition on acceptance of deposits from Public	The earlier provision of section 73(2)(c) has provided that company to deposit 15% of amount of maturing deposit during a financial year and the next financial year with a schedule bank in deposit repayment reserve account. NOW, the substituted new section 73(2)(c) provides that the company has to create a "deposit repayment reserve account" with a schedule bank account wherein the company has to deposit 20% of amount of deposit to be matured in subsequent year. The deposit has to be made before 30th April of each year. Thus, due to the above changes, the company is NOW required to keep more amount towards deposits maturing. Further instead of keeping deposit towards maturing amount for two financial years (i.e. during a financial year and the following financial year), it is now required to keep money for maturing Deposit in the following financial year. It has also provided clarity on the due date by which the above amount has to be deposited.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			The existing section 73(2) (d) related to taking deposit insurance has been deleted and thus company need not take any deposit insurance. The present provision under section 73(2)(e) is altered by providing that company to raise deposits after default in repayment of deposit or payment of interest thereon. Provided, that it has repaid all the money and only after 5 years from the date of making good the above default. This is welcome move as previously, once defaulted, company could not accept deposits in future.
6.	78	Application for registration of charge.	The amendment made to effect that in case the company fails to register a charge within a period of 30 days from the date of creation of charge, then the person in whose favour charge is created may apply to RoC for registration of the same. Earlier it has provided a period as provided in section 77. The section 77(1) provides for overall 300 days for filing charges. This makes the creditor or charge holder vulnerable as unregistered charges may affect their rights when borrower fails to register the charge within the statutory limit of 30 days and usually file in extended period of 300 days. NOW, the lender or creditor does not have to wait till the end of 300 days as they can register the charge themselves immediately after the expiry of 30 days. Thus, this amendment may help in securing the creditors interest by allowing them to file the charge in timely manner. This will also allow the public at large to check and verify the updated list of borrowings and security created by any company on MCA website.
7.	82 Not yet notified	Company to report satisfaction of charge	The first amendment to section 82(1) is in reference to section 77(1) related to filing of satisfaction of charge has been deleted. Further, it has inserted a new proviso to section 82(1), which NOW allows the filing of satisfaction of charge up to 300 days with late fees. Earlier filing of satisfaction of charge beyond 30 days was requiring condonation of delay from RD office which was not only time consuming but also a costly affair. NOW with this relaxation, the time for filing satisfaction of charge is extended to 300 days with RoC permission. Further form for satisfaction of charge can be filed by both i.e. the company or the charge holder.
8.	89	Declaration in respect of beneficial	The amendment are as follows. a. New sub-section 10 inserted after the existing sub-section 89(9).

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
		interest in any share.	The said new sub-section NOW states what includes in a "beneficial interest in share". Beneficial interest in a share covers directly or indirectly, through any contract arrangement or otherwise the right or entitlements either alone or with any other person to exercise all rights attached to shares or receive or participate in dividend distribution. Thus, this wide coverage may include cases of pledge with voting rights, transfer of dividend rights, etc., or any arrangement which typically form part of investment funding within its ambit. Further, there could be a practical issue as to determine - whether all arrangements entered into before this amendment have to comply with filing and disclosure requirements? b. The other amendments are in sub-section (6) and (7). In both these sub-sections, the delay in filing was referred to section 403, which section earlier allows additional 270 days for filing of forms with additional fees NOW, the above additional period under section 403 of 270 days is no more available and hence, the filing has to be done within 30 days or else, penalty and prosecution as provided in the newly amended section 403 shall apply.
9.	96 Not yet notified	Annual General Meeting	The new proviso added before existing proviso to section 96(2) and NOW, unlisted company may hold their AGM in any place in India, if consent in writing or by electronic mode is given by all shareholders.
10.	135 Not yet notified	Corporate Social Responsibility	The ambiguity of considering the relevant financial year for the applicability of the CSR is NOW cleared. Further the amendment to sub-section 1 of section 135, wherein for the words "any financial year" is replaced with the words "the immediately preceding financial year". Thus, it is NOW made clear that for applying any one of the three criteria for applicability of CSR like net worth, paid up capital or turnover, only preceding financial year figure has to be considered. Further, clarifying the requirements of number of directors or independent directors in CSR Committee, proviso is added to sub-section 1, wherein it is NOW clarified that where a company is not required to have independent directors' u/s. 149, it may have 2 or more than two directors. Thus for a private company or even unlisted public company, where there are either two directors or there is no requirement to have independent directors, the formation of committee is clarified.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
11.	136	Right of member to copies of audited financial statement.	This section is about the rights of shareholders to receive audited financial statements. While section 101 provides for minimum of 21 days' notice to be sent with audited financial statements and report before AGM to all the shareholders. It also allows to hold the AGM with a less than 21 days' notice, if certain number of shareholders gives consent to that effect. However, this section did not have any corresponding reference to such shorter notice consent for receiving audited financial statement, for a period less than 21 days. This leads to a practical difficulties and non-compliances under this section even though shareholders have given consent under section 101 for calling meetings at shorter notice. With the amendment, in sub section (1) of section 136, the words "without prejudice to the provisions of section 101", is omitted and the existing proviso is substituted with a new proviso. NOW, new proviso provides for requirement of the same number of shareholder's consent as provided in proviso to sub –section (1) of section 101. NOW, the issue notice of AGM for less than 21 days as well as sending the audited financial statements for less than 21 days with shorter notice consent as provided in section 101 and under this section is possible. The additional proviso is added by which it is obligatory for a listed company having subsidiary or subsidiaries to place on its website the separate account of each of such subsidiaries. In case of foreign subsidiaries, if country of incorporation of subsidiary requires to prepare consolidated financial and get it audited, then such audited consolidated financial otherwise, if audit is not required, then unaudited financial of such subsidiaries to be placed on web site of the listed company. In case of financial statements are not in English then translation thereof has to be posted on websites. Further, new proviso added to sub-section (2) by which, every company having subsidiary or subsidiaries shall provide the audited / unaudited financial statement of such subsidiary or subsidiaries to its shareholders if asked for.
12.	137	Copy of Financial Statement to be filed with Registrar	Earlier, it was provided that company can file the Financial Statements within 30 days from the date of AGM or adjourned AGM or such extended days which is up to 270 days as provided in section 403. NOW, the amendment has been made in sub-section (1), and reference to section 403 has been deleted,

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			which means that company has to file audited financial statements within 30 days from AGM date or adjourned AGM date and delay in filing will result in to payment of additional fees/double the fees as provided in section 403 and also prosecution and penalty as the case may be as provided in sub-section 3 of section 137 read with amended section 403. The filing of financial statements under section 137 also includes filing of financial statements of foreign subsidiary or subsidiaries also. However as mentioned in section 136, where foreign subsidiary is not required to prepare accounts or get it audited, then this section was silent as to whether unaudited financial statements can be filed or not and thus leads to non-compliance by the companies in absence of any provisions. The new proviso added after the fourth proviso to sub-section (1) NOW allows the company to attach unaudited financial statements of such subsidiary along with a declaration to this effect, together to be filed with RoC. It also provides that where such financial statements of subsidiary are in language other than English, translated copy shall also be attached.
13.	160	Right of persons other than retiring directors to stand for directorship.	Earlier, every person, who is proposed to be appointed as director other than retiring director, were required to deposit of INR 1 lakh. This was also applicable for the proposal of appointment of Independent directors' as per the provisions of the Act. However, such independent directors are being appointed only with the recommendation of the Board and hence it was felt that it is not appropriate to ask them to deposit the above amount. **NOW**, with the insertion of additional proviso, it is provided that where the appointment of Independent director or director recommended by NRC or Board (in case the company does not have NRC), requirement to deposit amount shall not apply.
14.	165	Number of directorships	As per this section, a person can be a director of maximum 20 companies. **NOW,** by inserting new Explanation No. II to sub-section (1), it has been clarified that maximum limit of 20 companies shall not include the directorship in a dormant company.
15.	167	Vacation of office of director	The earlier provisions of section 167(1)(a) has resulted into automatic vacation of office by a director, the moment he incurs disqualification under section 164(1) or 164(2) of the Act. While section 164(1) was considered as disqualification on personal grounds, whereas under section 164(2), was more related to the

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			compliances in relation to non-filing of annual returns or repayment of money to deposit holders / debenture holders etc., Thus, it clarified that only on personal ground as per section 164(1) the vacation of office should be considered and for reason under section 164(2), such director should allow to continue in the same company. This will also allow the said directors to make default good and comply with the requirements for said company or even new director, who is appointed can also complete the compliances. The other amendment is to the clause (f) of sub-section 1 whereby new proviso has been added that in case of any disqualification due to conviction by court for any offence and having sentenced imprisonment for not less than six months, the vacation of office by such director shall be effective only after certain period as provided from the date of conviction or if appeal or petition already made, then until seven days of expiry of disposing of such appeal or petition of further appeal or petition.
16.	177	Audit Committee	The amendment to sub-section 1 is more of clarifying in nature. The earlier requirement of constitution of an audit committee included all listed company irrespective of the company being private or public. This had created a practical issue till now, wherein even a private company having their debt securities/ instruments listed on stock exchanges were required to form an Audit Committee. **NOW** by this amendment -the term "every listed company" been replaced with the word "every listed public company" which has sought a relief to the private companies having their debt securities listed. The new provisos have been added after the existing proviso to sub-section 4. By this amendment, it has been clarified that (1) Transactions which does not fall under section 188 and which is not approved by the committee, then same should be recommended to the board. (2) Transactions of less than ₹ 1 crore entered without audit committee's approval, and if not ratified by audit committee within 3 months, then the same shall be voidable at the option of the audit committee and when such transactions are with related party to any director or approved by any other director, then director concerned has to indemnify the company.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
17.	178	Nomination and Remuneration Committee and Stakeholders Relationship Committee	The amendment to sub-section 1 is more of clarifying in nature. The earlier requirement of constitution of an NRC included all listed company irrespective of the company being private or public. This had created a practical issue till now, wherein even a private company having their debt securities/instruments listed on stock exchanges were required to form a NRC. NOW by this amendment -the term "every listed company" been replaced with the word "every listed public company" which has sought a relief to the private companies having their debt securities listed. The sub-section 2 is altered so now, instead of NRC's duties to "carry out the evaluation of every director's performance" it has to **NOW** specify the manner for effective evaluation of performance of Board, its committee and individual directors and review its implementation and compliance. It also NOW provides that such evaluation shall be carried out either by the Board, NRC or by independent external agency. Thus, involvement of having "external agency" is something new, and it may bring more professionalises expertise on review and international best practices. The new proviso also added after clause (c) to sub-section 4, whereby now, - Salient features of NRC policy and changes therein, if any, shall be disclosed in the board's report along with the link to the website where policy is posted. This is aligned to what second proviso to clause (q) of sub-section 3 of section 134 provides. The sub-section (8) provides for penalty for non-compliances of section 177 and section 178. The existing proviso to the above sub-section related to stakeholder Relation Committee has been altered so that instead of default by way of "non-consideration of resolution of any grievances", it has now made stricter provisions as to provide "inability to resolve or consider any grievances".
18.	180	Restriction on Power of Board	The existing clause (c) of sub-section (1) allows the Board to borrow up to the value of paid up share capital and free reserves without shareholders' approval. However, it has excluded the "securities premium account" which is nowadays, an important contributor to the "net worth "of the Company. This also restricts limit of the board to

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			borrow when company has substantial amount in securities premium account and not in free reserves. This has been now amended and clause (c) has now also included the "securities premium alongwith the paid up capital and free reserves.
19.	184	Disclosure of interest by director	Earlier, for contravention of this section, sub-section 4 has provided a minimum penalty of ₹ 50,000 to ₹ 1 lakh or imprisonment up to 1 year. Thus, it was felt that the minimum penalty is quite high and thus by amendment, the minimum limit has been deleted and thus authority may take more linient view for minor default and looking at company size for levying minimum penalty. The existing sub-section (2) includes the "body corporate" with regards to director interest for entering in to contract or arrangement by company. However, for exemption limit for entering in to such contract or arrangements as provided in sub-section (2), the existing clause (b) of sub-section (5) does not include the term "Body Corporate". Thus, while a contract with a company can be exempted if falls under limit specified in clause (b) of sub-section (5), but the contract with a Body Corporate" does not get any exemptions. It has been amended so as to include body corporate within the purview of section 184(5)(b) to align it with the provisions of section 184(2). This also could be considered as a change to align with the changes in definition of a Holding company which includes now "Body corporate".
20.	188	Related party transactions	The second proviso to sub-section (1), prohibits the interested members to vote for any resolution of related party contracts falls under certain transactions value limit as provided in the rules. This has created a practical issue for private companies or companies where most of the members are relatives to each other. Now third proviso has been added, whereby the requirement of related party to abstain from voting will not apply to a company in which ninety per cent or more members, in number, are relatives of promoters or are related parties.
21.	196 Not Yet Notified	Appointment of managing director, whole time director or manager	The second proviso has been added to sub-clause (3)(a) whereby for appointment / continuation of the appointment of a managing director, whole time director or manager who has attained the age of seventy years in case no special resolution has been passed but same has been approved by an ordinary resolution and the Central Government being satisfied on an application that such appointment is beneficial to the company.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			The amendment to sub-section (4) is related to the requirement of the Central Government approval, if the terms of appointment are at variance to the conditions as per Schedule V. The Schedule V has three parts, where by part I is about various conditions as to eligibility to be appointed. Whereas Parts II & III are more related to the payment of remunerations and conditions when there is inadequate profit or less profit. Since the amendment in sub-section (1) of section 197, as explained in subsequent para, there is no more requirements of obtaining the Central Government's approval for the remuneration even it is not as per Part II of the Schedule V. Thus, to align with said amendment, the word "Schedule V" is replaced with the words "specified in Part I of that Schedule" which means Schedule V.
22.	197 Not Yet Notified	Overall maximum managerial remuneration and managerial remuneration in case of absence or inadequacy of profits	The major amendments are as follows. In proviso to sub-section (1), earlier, when the remuneration to directors exceeds 11% of net profit same can be approved by obtaining shareholders consent through passing a special resolution and with the approval of the Central Government but subject to Schedule V. Now, in said proviso, the requirement of obtaining the Central government, has been deleted. Which means, company are free to decide the quantum of total remunerations and not linked to any maximum % of net profit except that it has to comply with the Schedule V requirements. In second proviso to sub-section (1), it is NOW added the requirement to have special resolution, instead of ordinary resolution for giving remuneration in excess of limits provided in second proviso to section 197(1). A new proviso after the second proviso has been added so for giving remuneration in excess of above limit, prior approval of banks/public financial institutions/non-convertible debenture holders/secured creditors in case of default before the approval of members in the general meeting. In sub-clause (3), where in case of no profits or inadequate profits, if company has to pay remuneration, which is not as per Schedule V, then with the permission of Central Government, it could pay so. Now, the approval from central government has been deleted. Thus, all such payments are purely decided as per Schedule V requirement only. The Sub-section 9 earlier has provided that any remuneration paid in excess of this section or without prior approval of the Central Government, then same has to be refunded and until refunded was to be kept in trust by such director.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
			NOW, sub-section 9 has been replaced with new section, which delete the requirements of prior permission of the Central Government and only company's permission is required. Further, for refund of such excess remuneration, it has also provided a time limit of 2 years or lesser time as may be approved by the company. The earlier, sub-section 10 has provided to obtain the Central Government approval, if company has to waive the refund of excess remuneration paid to the directors. NOW, the amendment has deleted the requirement of obtaining Central Government permission and instead provide for shareholders' approval by way of a special resolution within 2 years from such refund is due. However, it has added new proviso to sub-section 10 same in line with third proviso to sub-section (1) as above so as to require the prior approval of banks/public financial institutions/non-convertible debenture holders/secured creditors in case of default before obtaining the approval of members in the general meeting. In sub-section 11, the requirement of obtaining the Central Government approval has been deleted. Thus, now the company will decide about remuneration in case of inadequate profit or no profit as per Schedule V only. The new sub-section 16 provides that auditor shall in his report, has to make a statement as to compliance of these sections for the purposes of remuneration paid to a director and other details as may be prescribed. The new sub-section 17 also provides that upon effective this CAA 2017, all pending cases for excess remuneration etc., before the Central Government shall abate, and within one year from commencement of CAA2017, shall obtain the approval as provided in this section, which means shareholders approval as may be applicable.
23.	441	Compounding of certain offences	Earlier provisions allowed only the offences which attracts fine only was to be compounded by the Tribunal. However, it is NOW amended so as to allow the Tribunal to compound offences punishable with fine as well as offences punishable with imprisonment or fine or both. This is easing of compliances burden and provides relief to the officer / director as many of the offences occurred are more of technical / procedural in nature and hence requires leniency.

Sr. No.	Section reference	Amendments / Changes	Impact / Analysis
24.	447	Punishment for fraud	The amendment has now quantified as to what constitutes the "guilt of fraud". It has provided that guilt of fraud means - when it involves an amount of ₹ 10 lakhs or one per cent of turnover of the company, whichever is lower". It has also inserted new proviso after first proviso and provided that when fraud involves less amount than ₹ 10 lakhs or one per cent of turnover and does not involve public interest, then punishment shall be imprisonment up to 5 years or fine up to ₹ 25 lakhs or both.

References

1. Highlights of the Companies (Amendment) Bill, 2017 by ICSI
2. Report of the Companies Law Committee - February 2016
3. Standing Committee on Finance (2016-17) on the Companies (Amendment) Bill, 2016 dated December 2016.

The author acknowledges the contribution made by Ms. Hetal Pandya and Ms. Emriel Pereira Company Secretary.

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CA Mayur Nayak, CA Natwar Thakrar & CA Pankaj Bhuta

OTHER LAWS
FEMA Update and Analysis

In this article, we have discussed recent amendments to FEMA through Circulars, Notifications & recent FAQs issued by RBI & updation of Master Directions

A. Amendments to FEMA through AP Dir. Circular issued by RBI

1. Monthly reporting of External Commercial Borrowings (ECB) through ECB 2 Return

Annex III of Part V of Master Direction on Reporting under Foreign Exchange Management Act, 1999, as amended from time-to-time stipulates the reporting arrangement for ECBs through ECB-2 Return.

RBI has issued RBI/2017-18/193 A. P. (DIR Series) Circular No. 29 dated 7th June, 2018 through which an additional requirement has been inserted in ECB 2 providing for details of the hedges for ECBs through a simplified format. Part E of the Return, accordingly, is modified so as to include only standard information on hedged/unhedged ECB exposure. Details of hedging in Part E.1 of the Return and foreign exchange earnings and expenditure in Part E.2 of the Return should be furnished in additive format. The newly prescribed format is as under;

Amended E block in ECB-2 Return

Hedging details

Outstanding Principal ECB amount (in million)*	Currency	Financial hedge(s)		Natural hedge		Annualised percentage cost of financial hedge(s) for ECB
		Notional value (in million)	% of outstanding ECB amount	Notional value (in million)	% of Outstanding ECB amount	

*as on the last date of the reporting month

Foreign exchange earnings and expenditure, if any, for the last three financial years (only corresponding to same currency of ECB):

Financial Year	Currency	Foreign Currency earnings (in million)	Foreign Currency expenditure (in million)	Annual EBID** (in INR million)

**Earnings before Interest and Depreciation (EBID), as defined in table above = Profit After Tax + Depreciation + Interest on Debt + Lease Rentals, if any.

Further, for reporting in respect of natural hedge, provisions contained in A.P. (DIR Series) Circular No. 15 dated November 07, 2016 must be followed.

The monthly reporting format of ECB 2 Return revised as above would be applicable from month-end June 2018. Any lapse in reporting and/or failure to adhere to the time line of its submission and/or any lapse at the time of reporting through Form 83 will be a contravention of the provision of Foreign Exchange Management Act, 1999 (42 of 1999).

[RBI/2017-18/193 A.P. (DIR Series) Circular No. 29 dated 7th June, 2018]

2. Foreign Investment in India – Reporting in Single Master Form

With the objective of integrating the extant reporting structures of various types of foreign investment in India, a Single Master Form (SMF) for reporting of foreign investments by companies/LLPs/Start-ups in India has been prescribed. It is a single stop form for all reporting relating to foreign investment subsuming all previously notified forms. The SMF is to be filed online. The interface is available on RBI website https://firms.rbi.org.infrom June 28, 2018 to July 12, 2018. Companies/LLPs/start-ups with already existing Foreign Investment would first be required to report their existing total foreign investment in form Entity Master within the said time frame. Those not complying with this pre-requisite will not be able to receive foreign investment (including indirect foreign investment) and will be non-compliant with Foreign Exchange Management Act, 1999 and regulations made thereunder.

The new reporting requirements in SMF shall then commence from 12th July, 2018 onwards i.e., after reporting of existing investments in form Entity Master. The additional prescribed reporting requirements under SMF are as under;

Form FC-GPR

1. In case of reporting of fresh issue of shares, details of amount received in tranches for issue of partly paid up shares/ share warrants are now to be provided along with valuation certificate.
2. Details such as amount and date of any refund paid out of the inflow received now required to be mentioned.
3. In case of issue of CCPS/CCDS/share warrants, Pre-determined Conversion ratio & period of conversion also to be mentioned.
4. Pre-issue shareholding structure to be provided which was not asked for earlier.

Form FC-TRS

1. For reporting transfer of capital instruments from non-resident to resident, the acknowledgement letter for initial investment by non-resident is required to be enclosed.

2. In case of reporting transfer of shares way of deferred payment, details of tranches, escrow arrangement and indemnity arrangement are to be provided. Relevant extracts of transfer agreement to be enclosed in case of reporting transfer of shares.
3. Status (Person resident in India or Outside) of buyer & seller of shares is to be mentioned.
4. Details for payment to be made by way of swap of capital instruments needs to be included.
5. Nothing has been prescribed to bifurcate the transferred shares as listed or unlisted as previously needed in Form FC-TRS.

Form ESOP (For Employee Stock Options)

1. Required to mention the scheme under which ESOP is issued and attach relevant extracts of that scheme.
2. No need to specify the following:
   - the type of security
   - date of issue
   - names of persons to whom issued
   - consideration other than cash

Form CN (For Convertible Notes)

The entire reporting has been revised. Earlier only general details of receipt of funds and particulars of buyer and seller had to be reported. Now, details of repayment, conversion and transfer of convertible notes are required to be mentioned in case of reporting of convertible notes. For transfer of convertible notes from non-resident to resident, the acknowledgement letter for initial investment by nonresident is required to be enclosed.

Form DRR (For Depository Receipts):

1. Need to mention amount raised and issue expenses incurred, if any
2. The name and details of the lead manager/investment banker/sub managers are not required to be given.

General:

Certain requirements have been made common to all reporting, including certificate from a company Secretary and Chartered Accountant or valuer etc. for valuation/pricing of shares (which is currently required only in the case of Form FCGPR) and declaration by non-resident transferor/transferee (currently prescribed only for Form FC-TRS).

No changes have been made as such for reporting under earlier form LLP-I & Form LLP-II.

Form DI (Downstream Investment) & Form InVi (Investment in Vehicles) are newly introduced directly as a part of SMF. No previous reporting guidelines were prescribed for the same.

[RBI/2017-18/194 A.P. (DIR Series) Circular No. 30 dated 7th June, 2018]

(Comments: The new reporting guidelines look to simplify the existing burden on reporting by substituting one single form for all the compliances. The details asked for in SMF have been updated/increased;andthe form has been more comprehensive in its outlook covering all such transactions which were previously ignored. For e.g., Details of swap of capital instruments in Form FC-TRS.

As for a layman, the overall number of pages in SMF including the two newly added forms (Form DI & Form InVi) is comparatively less from the erstwhile individual forms combined. However, the flip side is that even if there is a need to file only Form FC-GPR, the whole SMF needs to be gone through and filled up. In the name of simplification, more details are sought by RBI which will be more burdensome than the earlier requirements).

3. Applicability of Provisions for breach of limits on acquisition/ transfer of capital instruments by FPI/NRI/OCI have now been notified.

RBI *vide* Notification No. FEMA.20(R) (2)/2018-RB has made applicable proviso (ii) to sub-regulation (1) of regulation 10 and proviso (ii) to sub-regulation (2) of regulation 10 of the Foreign Exchange Management (Transfer or Issue of Security by a person resident outside India) Regulations, 2017.

The above regulation deals with contravention by breach of sectoral limits by an FPI/NRI/OCI on acquisition of capital instruments of Indian Company from a recognised stock exchange in India. Where the person resident outside India is a FPI/NRI/OCI and the acquisition of capital instruments resulted in a breach of the applicable aggregate FPI limits or sectoral limits, the FPI/NRI/OCI is required to sell such capital instruments within five trading days after settlement to a person resident in India eligible to hold such instruments. The breach of the said aggregate or sectoral limit on account of such acquisition for the period between the acquisition and sale(provided the sale is within the prescribed five trading days after settlement) will not be reckoned as a contravention under FEMA 20(R).

The above provision was provided in the Master Direction but was not yet made applicable. The same shall now be effective from 2nd June, 2018.

4. Allowance of Investment in the units of an infrastructure investment trust (InvIT) by sponsor CIC-NDSI

In order to enable Systemically Important Non Deposit taking Core Investment Companies (CIC-NDSI) to act as a sponsor of InvITs, RBI *vide* RBI/2017-18/189 DNBR (PD) CC.No.093/03.10.001/2017-18 has decided to permit CIC-NDSIs to hold InvIT units only as a sponsor. Exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014.

The above holdings of InvIT units shall be reckoned as investments in equity shares in group companies, for the purpose of compliance with the norms prescribed in the Master Direction - Core Investment Companies (Reserve Bank) Directions, 2016 as updated from time-to-time.

5. Investment by Foreign Portfolio Investors (FPI) in Debt Securities

a. Minimum Residual Maturity Requirement relaxed

Earlier, the minimum residual maturity for investment in Government Bonds by FPI's was three years. Henceforth, in case of Central Government securities (G-secs), including Treasury Bills, and State Development Loans (SDLs) there is no restriction on minimum residual maturity requirement and in case of corporate bonds, the minimum residual maturity is of above one year. However, this relaxation is subject to the condition that short-term investments by a FPI under either category shall not exceed 20% of the total investment of that FPI in that category on an end-of-day basis i.e., at the end of any day, all investments with residual maturity of up to one year will be reckoned for the 20% limit. These stipulations will not apply to investments in SRs by FPIs.

However, these investments by an FPI may exceed 20% of total investments, only if the short-term investments consist entirely of investments made on or before April 27, 2018.

[RBI/2017-18/199 A.P. (DIR Series) Circular No. 31 dated 15th June, 2018]

(Comments: Accordingly, if an FPI makes even a single short term investment after 27th April, 2018 the entire exemption won't apply to him. i.e. short term investment by FPI should then

not exceed 20% in any case else the minimum maturity requirement relaxation shall lapse).

b. The cap on aggregate FPI investments in any Central Government security which was currently at 20% of the outstanding stock of that security is revised to 30% of the outstanding stock of that security.

c. FPI shall not invest in partly paid debt instruments.

d. Online monitoring of investments in G-sec and SDL Categories

Utilisation of FPI investment limits in G-secs and SDLs is being monitored online by the Clearing Corporation of India Ltd. (CCIL). For, Custodians and FPIs any transaction that leads to a breach of the investment limit for the category will need to be reversed. The primary responsibility of complying with all limits for investment in G-secs and SDLs shall lie with the FPIs and custodians.

e. Extension for compliance of Single/Group investor wise limits in corporate bonds for new FPI's

For investments by FPIs made after April 27, 2018 in corporates other than those for which exposure is in excess of 20% to any corporate would be exempted from not having an exposure of more than 20% of its corporate bond portfolio to a single corporate till March 31, 2019. This requirement should be complied thereafter.

Also, newly registered FPIs registering after April 27, 2018 are permitted to comply with this requirement by March 31, 2019, or six months from the date of registration, whichever is later.

Investment by FPIs in corporate bonds that were under process but had not materialised as on April 27, 2018 (pipeline investments), shall be exempt from theaboverequirements , subject to the custodian of the FPI reasonably satisfying itself that:

a. The price/rate, tenor and amount of the investment have been agreed upon between the FPI and the issuer on or before April 27, 2018;

b. The actual investment will commence by December 31, 2018; and

c. The investment is in conformity with the extant regulations governing FPI investments in corporate bonds prior to April 27, 2018.

6. Liberalised Remittance Scheme – Mandatory Requirement for PAN & Modified definition of 'Relative'

Previously, furnishing of Permanent Account Number (PAN) was not insisted upon while carrying permissible current account transactions of up to USD 25,000. Now, *vide* RBI/2017-18/204 A.P. (DIR Series) Circular No. 32, it has been notified that PAN is mandatorily required to be quoted for making all remittances under Liberalized Remittance Scheme (LRS).

Further, in the context of remittances allowed under LRS for maintenance of close relatives, the definition of 'relative' shall be aligned with the definition given in Companies Act, 2013 instead of Companies Act, 1956.

[RBI/2017-18/193 A.P. (DIR Series) Circular No. 32 dated 19th June, 2018]

The remittances made under this Scheme will be reported in FETERS (Foreign Exchange Transactions – Electronic Reporting System) in the normal course. The Authorized Dealers may also prepare and keep on record dummy Form A2, in respect of remittances less than USD 25,000. In addition, AD banks may be guided by FED Master Direction No. 18/2015-16 dated January 1, 2016 (as updated from time-to-time) on Reporting under FEMA, 1999 for reporting related instructions under the Scheme.

Notification No. FEMA. 20(R)(2)/2018-RB dated 1-6-2018.

The RBI has notified that, provisio (ii) to sub-regulation (1) of regulation 10 (which refers to FPI and the acquisition of capital instruments made under Schedule 2) and provisio (ii) to sub-regulation (2) (which refers to the acquisition of capital instruments by an NRI or an OCI under the provisions of Schedule 3) of regulation 10 of the Foreign Exchange Management (Transfer or Issue of Security by a person resident outside India) Regulations, 2017, shall come into force with effect from June 2, 2018.

New insertions and modifications in FAQs

a) FAQs – External Commercial Borrowings & Trade Credits

RBI Update on FAQs on External Commercial Borrowings & Trade Credits as on June 7, 2018 contains the following changes:

Question 18 has been newly inserted as under:

Q.18. Whether the restrictions in respect of the eligibility of borrowing entities also applicable to Start ups?

Ans. No, any entity which is recognised as a Start up by the Central Government as on date of raising ECB, would be eligible to raise ECB, irrespective of its business activities,.

Question 32 has been amended as under:

Q.32. Can ECB be raised under Track I and Track III for general corporate purpose (including working capital)? What will be its minimum average maturity period?

Ans. ECB can be raised under Track I and Track III for general corporate purpose (including working capital) only from foreign equity holders. The minimum average maturity period will be 5 years, irrespective of amount borrowed.

A. FAQs on Names of International banks which have entered into a correspondent banking relationship with Iranian banks

RBI Update contains the following change:

The bank *'Julius Baer Group'* has been removed from this list.

FAQs – Overseas Direct Investments

RBI update on FAQs on Overseas Direct Investments as on June 18, 2018 contains the following changes:

The Question No. 27 and 32(c) remain the same. However, the answer 27(c) has been newly inserted and the answer 32(c) has been amended.

Q.27 Is it mandatory to furnish Annual Performance Reports (APR) of the overseas JV/WOS based on its audited financial statements?

Ans. (c) The above exemption from filing the APR based on unaudited balance sheet will not be available in respect of JV/WOS in a country/jurisdiction which is either under the observation of the Financial Action Task Force (FATF) or in respect of which enhanced due diligence is recommended by FATF or any other country/jurisdiction as prescribed by Reserve Bank of India.

Q.32. (c) Can an Indian company set up JV/WOS for trading in Overseas Commodities Exchanges?

Ans. Trading in Commodities Exchanges overseas and setting up of JV/WOS for trading in Overseas Commodities Exchanges will be reckoned as financial services activity and will require clearance from Securities and Exchange Board of India (SEBI) on account of merger of Forward Markets Commission with SEBI.

We have not covered Compounding orders passed in the month of May 2018 since the contraventions highlighted in such orders relate to procedural lapses and have already been covered in previous issues of FEMA Updates.

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CA Deepak K Shah

In Focus – Accounting and Auditing

Issue of Certificate for Special Purposes by a Practitioner

Background

An important phenomenon of recent times is the rapid growth of the accountancy profession. The vast changes occurring in the economy of the country have been placing great responsibilities on the Chartered Accountants. It also constitutes a challenge to the profession to bring to bear their knowledge and skill in their specialised fields of activity. It becomes the duty of chartered accountant to keep the pace with such a rapid growth keeping his quality intact and ethics in place.

Practitioners are often called upon to issue certificates for special purposes e.g., certificates required under the tax laws/other laws, Government welfare schemes like MGNREGA, Net worth Certificate, Turnover Certificate, Working Capital, Others for Tender Purposes. Sometimes, these special purpose reports/ certificates are also required from the members/ practitioners by the management of the entities for their own purposes. For discharging their duties a Member should adhere all the standards and guidance issued by ICAI in order to maintain their Independence and ethical standards.

Basis and Source of Subject

Auditing & Assurance Standards Board (AASB) of the Institute of Chartered Accountants of India (ICAI), in 1984, had issued the Guidance Note on Audit Reports and Certificates for Special Purposes to provide guidance to the members carrying out engagements to issue reports/certificates for special purposes. This guidance note was further revised in 2016.

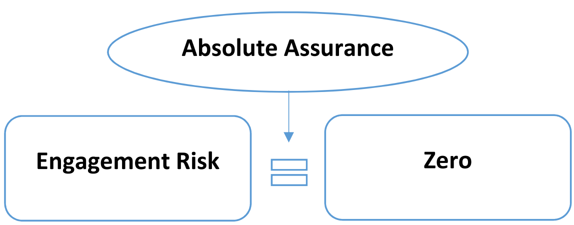
Scope of the Guidance Note

This Guidance Note covers assurance engagements other than audits or reviews of historical financial information, as described in the Framework for Assurance Engagements. This Guidance Note does not apply to assurance engagements for which subject specific Standards on Assurance Engagements have been issued by the ICAI.

This Guidance Note can also be applied on the reports or certificates related to historical non-financial information that a practitioner may be called upon to issue from time-to-time. ICAI, from time-to-time, issues specific Guidance Notes to provide guidance on certain assurance engagements. While complying with the requirements of those specific Guidance Notes, a practitioner may also draw guidance from the principles enunciated in this Guidance Note.

Brief Overview

The major highlight of this Guidance Note is, that the Chartered Accountant as a certification authority can only give "Reasonable Assurance" or "Limited Assurance". Absolute Assurance cannot be given by any member unless and the risk level is bought down to level "Zero" which is practically not possible in major of the cases because there are inherent limitations attached to the procedures which a practitioner may perform in relation to issuance of certificate. Hence use of words "Certified" and "True" should not become part of our Opinion paragraph.



The above is not possible in many cases due to the inherent Limitations which may arise from:

a) the nature of financial reporting;

b) the use of selective testing;

c) the inherent limitations of internal controls;

d) the fact that much of the evidence available to the practitioner is persuasive rather than conclusive;

e) the nature of procedures to be performed in a specific situation;

f) the use of professional judgment in gathering and evaluating evidence and forming conclusions based on that evidence;

g) in some cases, the characteristics of the underlying subject matter when evaluated or measured against the criteria;

and;

h) the need for the engagement to be conducted within a reasonable period of time and at a reasonable cost.

The word 'certificate' as described in the laws and regulations or even in the contracts that an entity might have entered into can normally be associated with ***reasonable assurance***. However, depending upon the circumstances and based upon the nature, timing and extent of the procedures which a practitioner can perform, the practitioner can conclude that a reasonable assurance cannot be expressed on the subject matter of the "certificate" and only limited assurance conclusion can be given. The practitioner's procedures in case where reasonable assurance is to be expressed would be substantially different and more extensive than from circumstances where limited assurance is to be expressed.

The Guidance Note, lists the different procedures to be performed in a reasonable assurance engagement *vis-a-vis* limited assurance engagement. For the purpose of understanding the underlying subject matter and other engagement circumstances, the practitioner should make following appropriate enquiries:

a) Whether the responsible party has a commensurate internal audit function and whether there are any findings by the Internal audit function in relation to the subject matter.

b) Whether the responsible party has used the work of any expert for the purpose of preparation of the matter of subject information.

c) Whether there is any actual or suspected of alleged non-compliance with laws and regulations which will have an impact on the subject matter.

The practitioner should also consider the following points at the time of providing reasonable or limited assurance:

Limited Assurance	Reasonable Assurance
While providing limited assurance the practitioner should obtain an understanding of the underlying subject matter to: a) Enable the practitioner to identify areas where a material misstatement of the subject matter information is likely to arise and b) Provide a basis for designing and performing procedures to address the areas identified and to obtain limited assurance to support the conclusion	While providing reasonable assurance the practitioner should obtain an understanding of the underlying subject matter to: a) Enable the practitioner to identify and assess the risks of material misstatement in the subject matter information, and b) Provide a basis for designing and performing procedures to address the assessed risks in order to obtain reasonable assurance to support the practitioner's opinion
The practitioner should also consider and critically study the process adopted to prepare the information in the subject matter	The practitioner should also obtain an understanding of internal control over the preparation of the subject matter information relevant to the engagement. This includes evaluating the design of those controls relevant to the engagement and determining whether they have been implemented by performing procedures in addition to the inquiry of the personnel responsible for the subject matter information.

Other Aspects

- **Use of Expert**

A practitioner can use the work of an expert in assurance engagement after evaluating whether the practitioner's expert has the necessary competence, capabilities and objectivity for the practitioner's purposes. Practitioner should enter into agreement with expert on the nature, scope and objectives of that experts work. Evaluate the adequacy of the work of the Experts in relation to the assurance subject matter. If the practitioner refers to the work of a practitioner's expert in the assurance report, the wording of that report should not imply that the practitioner's responsibility for the opinion/conclusion expressed in that report is reduced because of the involvement of that expert.

- **Assurance Report prescribed by Law or Regulation**

Sometimes law or regulations prescribes the layout or wording of the assurance report. In such cases practitioner needs to evaluate whether wordings will not lead the user to misunderstand the subject matter or assurance conclusion and if so happens then practitioner is require to give additional explanation in assurance report to bring down risk of misunderstanding.

In some cases authorities will reject the assurance report with any explanation or modification in the format. Then in that case practitioner needs to document such rejection and only after that he should issue assurance report. Such assurance report shall be enclosed with the statement having elements as given in point no. 8 of table given above (minimum elements in assurance report). A reference should be made in main assurance report in regards such statement like "in terms of our statement as on even date" or "to be read with the enclosed statement of even date". Such statement should include the fact in regards to rejection of original assurance report and reasons for such rejection.

Documentation

The documentation criteria as set out in the Guidance Note are more or less similar to SA 230 (revised) and compliance with the requirement of SQC1. It includes documentation of:-

1. The nature, timing and extent of the procedures performed to comply with the Guidance Note and applicable legal and regulatory requirements; *(like checklist as illustrated below)*

2. The results of the procedures performed, and the evidence obtained; and

3. Significant matters arising during the engagement, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

Guidelines detailing Assurance Engagement

Guidance note outlines the way in which Certificate should be drafted, minimum contents of the certificate and disclosures if any (case to case).

Steps for Issuing Certificates: (Given in Checklist format)

S. No.	Particulars	✓ Tick
1	Enter into terms of engagement through engagement letter or other suitable form of written agreement. Minimum things required in letter of engagement are:	
	a Objective & Scope of engagement	
	b Responsibilities of practitioner	
	c Responsibility of engaging party/ responsible party	
	d Identification of suitable criteria to be used along with reference to relevant law or regulation or contract if any	
	e Unrestricted access to all the records and information requested in connection with the engagement.	
	f Reference to the expected form and content of report to be issued by the practitioner.	
	g A statement that there may be circumstances in which a report may differ from its expected form and content.	
2	Planning and performing assurance engagement with professional skepticism & judgement.	
3	Consideration of Materiality while performing assurance engagement considering qualitative and quantitative factors as to persons affected by the assurance report or magnitude of misstatement in such report.	
4	Understand other factors like internal audit function and their findings make inquiries about whether they are having any alleged intentional misstatement or non-compliance with laws and regulations affecting subject matter information.	

S. No.		Particulars	✓ Tick
5	Obtaining evidences in relation to subject-matter which are part of assurance engagement. While obtaining evidences one needs to check whether:		
	a	Does evidence obtained provide reasonable response towards Risk considered while planning engagement.	
	b	Whether the evidence obtained is reliable and to assess whether there is need to obtain from other source or not.	
	c	Should any further audit procedure required to be followed in further substantiation of evidence.	
6	To obtain written representation from client:		
	a	That it has provided the practitioner with all information of which the appropriate party(ies) is aware that is relevant to the engagement.	
	b	Confirming the measurement or evaluation of the underlying subject matter against the applicable criteria, including that all relevant matters are reflected in the subject matter information.	
	c	Any other point as seems necessary by the practitioner in relation to assurance report.	
	The date of written representation *should not be after* the date of assurance report.		
7	Forming the conclusion of Assurance report. (Reasonable/ Limited Assurance and wherever required Qualified opinion)		
8	***Preparation of assurance report. Guidance note provides with the list of minimum elements to be included in the report. This can be taken care of by referring following checklist/list:***		
	a	A title that clearly indicates the report is an independent assurance report.	
	b	An addressee. (It cannot be "To Whomsoever it may Concern")	
	c	The date of the assurance report.	
	d	A subject matter information and, when appropriate, the underlying subject matter.	
	e	Identification of the applicable criteria against which the underlying subject matter was measured or evaluated:	
		i. The source of the applicable criteria.	
		ii. Measurement or evaluation methods used when the applicable criteria allows for choice between a number of methods.	
		iii. Any significant interpretations made in applying the applicable criteria in the engagement circumstances.	
		iv. Whether there have been any changes in the measurement or evaluation methods used.	

S. No.		Particulars	✓ Tick
	f	Description of any significant inherent limitations associated with the measurement or evaluation of the underlying subject matter against the applicable criteria.	
	g	When the applicable criteria are designed for a specific purpose, a statement restricting its use or its users.	
	h	A statement to identify the responsible party (generally management's responsibility statement).	
	i	A statement that the firm/practitioner has applied SQC 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.	
	j	A statement that the engagement was performed in accordance with this Guidance Note and other ethical requirements of the Code. For e.g.: "We conducted our engagement in accordance with the Guidance Note on Reports or Certificates for Special Purposes issued by the Institute of Chartered Accountants of India. That Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India."	
	k	An informative summary of the work performed as the basis for the practitioner's opinion/conclusion.	
	l	Opinion/conclusion paragraph. In case of modified opinion/conclusion, the assurance report should contain:	
		i. A section that provides a description of the matter(s) giving rise to the modification; and	
		ii. A section that contains the practitioner's modified opinion/conclusion.	
	m	The practitioner's signature.	
	n	The place of signature.	

Following is an exhibit of draft certificate giving assurance for annual turnover of XYZ Private Limited:-

To,
The Board of Directors,
XYZ Private Limited
ABC Tower, QWERTY Park,
Greater Parel (West),
Mumbai – 400013

Independent Practitioner's Report on the Statement of Annual Turnover from Development of Value Added Services and Software Development for last three financial years 2014-15, 2015-16 and 2016-17.

1. This report is issued in accordance with the terms of our engagement letter dated 1st February, 2018.

2. The Statement of Annual Turnover from Development of Value Added Services and Software Development for last three financial years 2014-15, 2015-16 and 2016-17 (hereinafter referred together as the "Statement") as given in below table contains the details as required pursuant

to compliance with the terms and conditions contained in clause 8.1 of the Tender document issued by YYY Limited having Tender Number as AAA/DDD/17-18/033 dated 2-1-2018 (hereinafter referred to as the "Tender Document"), which we have initialled for identification purposes only.

S. No.	Financial Years	Annual Turnover of Bidder (In INR)
1	FY – 2014-15	XXX
2	FY – 2015-16	XXX
3	FY – 2016-17	XXX
4	Average Annual Turnover	XXX

Management's Responsibility for the Statement

3. The preparation of the statement is the responsibility of the management of XYZ Private Limited (hereinafter the "Company") including the preparation and maintenance of all accounting and other relevant supporting records and documents. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of the Statement and applying an appropriate basis of preparation; and making estimates that are reasonable in the circumstances.

4. The management is also responsible for ensuring that the Company complies with the requirements of the Tender Document and provides all relevant information to YYY Limited.

Practitioner's Responsibility

5. Pursuant to the requirements of the tender document, it is our responsibility to provide a reasonable assurance whether:

   i. The amounts in the statement of Annual Turnover from Development of Value Added Services and Software Development for last three financial years 2014-15, 2015-16 and 2016-17 have been accurately extracted from the audited financial statements; and

6. The audited financial statements referred to in paragraph 5 above, have been audited by us, on which we issued an unmodified audit opinion *vide* our reports dated 31st August, 2015 for F.Y. 2014-15, 29th August, 2016 for F.Y. 2015-16 and 4th September, 2017 for F.Y. 2016-17 respectively. Our audits of these financial statements were conducted in accordance with the Standards on Auditing and other applicable authoritative pronouncements issued by the Institute of Chartered Accountants of India. Those Standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

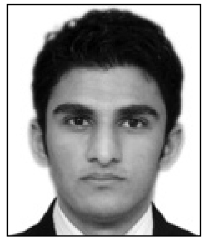
7. We conducted our examination of the statement in accordance with the Guidance Note on Reports or Certificates for Special Purposes issued by the Institute of Chartered Accountants of India. The Guidance Note requires that we comply with the ethical requirements of the Code of Ethics issued by the Institute of Chartered Accountants of India.

8. We have complied with the relevant applicable requirements of the Standard on Quality Control (SQC) 1, Quality Control for Firms that Perform Audits and Reviews of Historical Financial Information, and Other Assurance and Related Services Engagements.

Emphasis of Matter

9. The term Annual Turnover from Development of Value Added Services and Software Development or the manner of its calculation is nowhere defined in the tender document. As per the representation made by the management,

[Contd... on page 230]



Rahul Sarda, *Advocate*

Best of the Rest

1. Property owned by minor under a registered gift deed from grandfather could not be attached for criminal act of money laundering of his father

The appeal was filed by a minor aged about 14 years, represented by his father and natural guardian. The father of the Appellant was alleged to have been involved in money laundering. The minor was not charged in any matter pertaining to money laundering. In the date of the alleged offence committed by the Appellant's father, the age of the Appellant was about 6 years. The gift deed by which the property in question was gifted to the Appellant was registered and made before the date of alleged involvement of his father in the offence. Therefore, the property of the minor could not be attached under the provisions of Prevention of Money Laundering Act.

Master Pavitra Agarwal vs. Joint Director, Directorate of Enforcement, Hyd. [2018] 94 taxmann.com 53 (PMLA-AT)

2. Insolvency and Bankruptcy Code – Delay by professional in taking charge of a company under corporate insolvency resolution process to be excluded for purposes of counting period of 180 days

The petition under the Insolvency and Bankruptcy Code was admitted on 16th August 2017. The proposed resolution professional, upon receipt of intimation of his appointment, took charge on 14th September 2017. The corporate insolvency resolution period is of 180 days (further extendable by 90 days). Held, since the resolution professional took charge after almost one month, the said period during which the petition was admitted for corporate insolvency resolution and the date on which the resolution professional actually took charge of the company was liable to be excluded from the corporate insolvency resolution period.

Velamur Varadan Anand vs. Union Bank of India [2018] 94 taxmann.com 58 (NCLAT – New Delhi)

3. Insolvency and Bankruptcy Code – Assured returns – Failure to pay – Financial debt – Application liable to be admitted

The Respondent had entered into sale/ purchase MOU with Petitioner for sale/ purchase of constructed space. The Petitioner disbursed total sale consideration under the MOU and opted for the assured returns plan under the said MOU.

Accordingly, the Respondent was to pay a monthly sum to the Petitioner until 50 months or offer of possession whichever was later. However, the Respondent stopped making the payment of assured returns since April, 2016 and committed default in the payment of the monthly assured returns.

The Petitioner claimed to be a financial creditor and filed an application under the provisions of the Insolvency and Bankruptcy Code. Held, in cases where there is a commitment to pay assured returns, the same amounts to financial debt and the application is liable to be admitted and resolution professional was liable to be appointed.

Tek Chand vs. Premia Projects Limited [2018] 94 taxamnn.com 267 (NCLT – New Delhi)

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[Contd. from page 228]

the company develops Platform for providing IT Enabled Services which is understood by the management as Development of Value Added Services. For the purpose of calculation of Annual Turnover of such services we have considered Mail Marketing Services, Mobility Services and other related services.

Opinion

10. Based on our examination, as above, we are of the opinion that the amounts in the Statement in respect of annual turnover from Development of Value Added Services and Software Development have been accurately extracted from the audited financial statements financial years 2014-15, 2015-16 and 2016-17;

Restriction on Use

11. The certificate is addressed to and provided to the Board of Directors of the Company solely for the purpose to enable comply with requirement of tender document and to submit the accompanying statement to YYY Limited, and should not be used by any other person or for any other purpose. Accordingly, we do not accept or assume any liability or any duty of care for any other purpose or to any other person to whom this certificate is shown or into whose hands it may come without our prior consent in writing.

Certificate No. ___________
For **GUIDING PROFESSIONAL ASSOCIATES**
Chartered Accountants
Registration No. ___________

ABC
Partner
Membership No.
Mumbai:

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That which tends to increase the divinity in you is virtue, and that tends to increase brutality in you is vice.

— Swami Vivekananda


CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

91ST ANNUAL GENERAL MEETING – A BRIEF REPORT

At the 91st Annual General Meeting held on Wednesday 4th July, 2018 the following business was transacted:

i) The Annual Report for the year 2017-18 was approved and adopted.

ii) The Accounts for the year ended 31st March, 2018 were adopted.

iii) CA J. L. Thakkar, was appointed as the Auditor for the year 2018-19 and will hold office up to the next AGM.

iv) Results of the elections for the year 2018-19 were declared as follows:

- **Mr. Hinesh R. Doshi** was elected as the President for the year 2018-19..
- The following 14 members were elected to the Managing Council for the year 2018-19:

1. Mr. Anish Thacker
2. Mr. Bhadresh Doshi
3. Mr. Bhavesh Joshi
4. Mr. Devendra Jain
5. Mr. Dinesh Tejwani
6. Mr. Heneel Patel
7. Mr. Ketan Vajani
8. Mr. Naresh Sheth
9. Ms. Nishtha Pandya
10. Mr. Parag Ved
11. Mr. Paras S. Savla
12. Mr. Rahul Hakani
13. Mr. Rajesh P. Shah
14. Mr. Vipul Choksi

THE DASTUR ESSAY COMPETITION

The Top Three Winners of the Eassy Competition were felicitated. These are:

Rank	Participant Name	Topic	Firm/College
1	Ms. Krisha Jitesh Sanghvi	What Swachh Bharat signifies for me and way forward	Hinesh R. Doshi & Co. LLP, Chartered Accountants, Mumbai
2	Mr. Umang Upendra Gupta	GST- Boon or Bane	Khandelwal Jain & Co., Chartered Accountants, Mumbai
3	Mr. Meet Hiren Shah	Is intolerance growing nationally and internationally?	GBCA & Associates Chartered Accountants, Mumbai

The first three ranked essay authors of the Dastur Essay Competition were given a Trophy, Certificate and a cheque. Ms. Bijal Sanghvi (5th Place Winner) & Mr. Sagar Khandelwal (9th Place Winner) were also felicitated by offering them a Appreciation Certificates and a Memento.

RELEASE OF PUBLICATIONS

Shri Y. P. Trivedi, Past President, released the publication on "Key Rulings under Indirect Tax Laws"; Dr. K. Shivaram, Past President, released the publication on "Prevention of Money Laundering Act - A Handbook", and Shri Sharad R. Dalal, Past President, released the publication on "FEMA – Fundamental Aspects and Practical Issues".

THE TEAM FOR THE YEAR 2018-19

i) At the First Managing Council Meeting held on Wednesday, 4th July, 2018, after the 91st AGM, the following members were elected as Office Bearers:

	Name	*Designation*
1.	Mr. Vipul Choksi	Vice President
2.	Mr. Anish Thacker	Hon. Jt. Secretary
3.	Mr. Parag Ved	Hon. Jt. Secretary
4.	Mr. Ketan Vajani	Hon. Treasurer

ii) The following nine members (in Alphabetical Order) were Co-opted to the Managing Council for the year 2018-19:

1. Mr. Ashok Sharma
2. Mr. Hitesh R. Shah
3. Mr. Jayant Gokhale
4. Mr. Kishor Vanjara
5. Mr. Mahendra Sanghvi
6. Mr. Manoj Shah
7. Mr. Paras K. Savla
8. Mr. Sanjeev Lalan
9. Mr. Vipul Joshi

iii) **EDITOR & EDITORIAL BOARD OF THE CHAMBER'S JOURNAL:**

Shri V. H. Patil was appointed as the Editor-in-Chief of the Chamber's Journal. Shri K. Gopal was appointed as the Editor of the Chamber's Journal for the year 2018-19.

S/Shri Ajay. Singh, Anish Thacker, Manoj Shah, Paras K. Savla, Vikram Mehta and Yatin Vyavaharkar were appointed as Assistant Editors.

The following members (in alphabetical order) were appointed as Editorial Board Members:

1. Shri A. S. Merchant
2. Shri Jayant Gokhale
3. Shri K. B. Bhujle
4. Shri Kishor Vanjara
5. Shri Pradip Kapasi
6. Shri Vipul Joshi

iv) **COMMITTEES**

The following Committees were formed and their Chairmen were appointed: (In Alphabetical Order)

Sr. No.	Committees	Chairman/Chairperson
1.	Allied Laws	Mr. Rahul Hakani
2.	Accounting & Auditing	Mr. Heneel Patel
3.	Corporate Connect	Mr. Paras K. Savla
4.	Direct Taxes	Mr. Devendra Jain
5.	Indirect Taxes	Mr. Naresh Sheth
6.	International Taxation	Mr. Rajesh P. Shah
7.	IT Connect	Mr. Dinesh Tejwani
8.	Journal	Mr. Bhadresh Doshi
9.	Law & Representation	Mr. Mahendra Sanghvi
10.	Membership & Public Relations	Mr. Sanjeev Lalan
11.	Research & Publication	Mr. Paras S. Savla
12.	Residential Refresher Course & Skill Development	Mr. Bhavesh Joshi
13.	Student	Ms. Nishtha Pandya
14.	Study Circle & Study Group	Mr. Ashok Sharma

DELHI CHAPTER

The following members were appointed as Chairman and Office Bearers of Delhi Chapter:

1.	Chairman	Mr. Suhit Agarwal
2.	Vice-Chairman	Mr. Vijay Gupta
3.	Hon. Jt. Secretaries	Mr. Harish Kumar
		Mr. Deepender Kumar Agarwal
4.	Hon. Treasurer	Mr. Prakash Sinha

PUNE STUDY GROUP

The following members were appointed as Convenors / Co-ordinators of Pune Study Group.

1. Mr. Sachin Sastakar & Mr. Shridhar Pathak - Convenors
2. Mr. Sunil Vaidya & Mr. Mehul Shah - Co-ordinators

PAST EVENTS

ALLIED LAWS COMMITTEE

Full Day Workshop on New Benami Law

The full day workshop on "New Benami Law " was held on 30th Jue, 2018 at West End Hotel, Mumbai. The workshop was inaugurated by Shri Firoze Andhyarujina, Sr. Advocate who also delivered the keynote address. CA Pradip Kapasi, Dr. Dilip K. Sheth, Shri Ashwani Taneja, Advocate and Shri Sandeep Pasbola, Advocate addressed the participants of workshop.

INTERNATIONAL TAXATION COMMITTEE

12th Residential Conference on International Taxation

The 12th Residential Conference on International Taxation was held from 21st-24th June, 2018 at The Grand Bhagwati, Indore. The Conference was inaugurated by Justice (Retd.) Shri Vishnu S. Koje. The Conference was attended by 220 delegates and was addressed by eminent faculties in the field of International Taxation.

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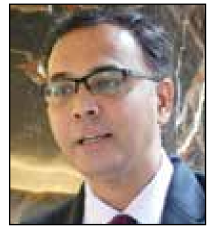
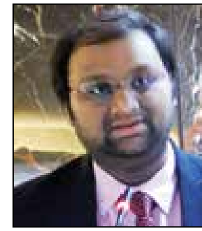
Allied Laws Committee

Ful Day Seminar held on New Benami Law on 30th June, 2018 at West End Hotel, Mumbai

Dignitaries at the inaugural session. Seen from L to R: S/Shri Rahul Hakani, Chairman, Allied Laws Committee, Dr. Dilip K. Sheth, CA Pradip Kapasi, Shri Ashwani Taneja, Advocate, Faculty, Ajay R Singh, President, Firoze Andyarujina, Keynote Speaker, Paras S. Savla, Co-Chairman, Allied Laws Committee



Shri Ajay R. Singh, President giving opening remarks



Shri Rahul Hakani, Chairman, Allied Laws Committee welcoming the members and faculty

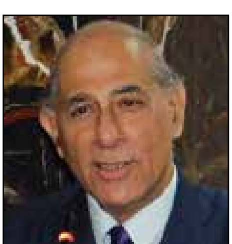
Shri Paras S. Savla, Co-Chairman, Allied Laws Committee welcoming the Faculty Pradip Kapasi. Seen from L to R: S/Shri Rahul Hakani, Chairman, Ajay R. Singh, President, Pradip Kapasi, Faculty

Shri Apurva Shah, Vice Chairman, Corporate Connect Committee, welcoming Faculty Dr. Dilip K. Sheth. Seen from L to R: S/Shri Aditya Ajgaonkar, Hinesh Doshi, Vice President, Dr. Dilip K. Sheth, Faculty

Shri Hinesh Doshi, Vice President, presenting memento to Dr. Dilip K. Sheth, Faculty

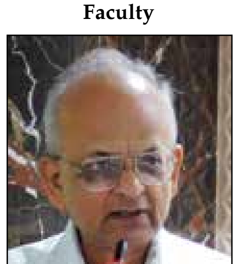
Shri Pravin Veera, Advisor, Allied Laws Committee welcoming Faculty, Shri Sudeep Pasbola. Seen from L to R: S/Shri Aditya Ajgaonkar, Sudeep Pasbola, Faculty, Paras S. Savla, Co-Chairman, Allied Laws Committee

Faculty

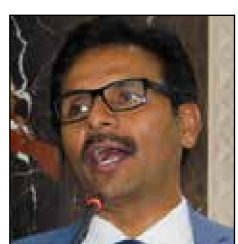


Shri Firoze Andhyarujina, Sr. Advocate

CA Pradip Kapasi



Dr. Dilip K. Sheth



Shri Ashwani Taneja, Advocate

Shri Sudip Pasbola, Advocate

International Taxation Committee

12th Residential Conference on International Taxation, 2018
held from 21st June, 2018 to 24th June, 2018 at The Grand Bhagwati, Indore

Shri Ajay R. Singh, President giving opening remarks

CA Rajesh P. Shah, Chairman, International taxation Committee, welcoming the Chief Guest. Seen from L to R: S/Shri Bhaumik Goda, Co-ordinator, Justice (Retd.) Shri Vishnu S Koje, Chief Guest, Ajay R. Singh, President, Rajesh L. Shah, Co-Chairman, Harshal Bhuta, Convenor

Dignitaries at the inaugural session. Seen from L to R: S/Shri Bhaumik Goda, Co-ordinator, Hinesh Doshi, Vice President, Rajesh P. Shah, Chairman, Justice (Retd.) Shri Vishnu S. Koje, Chief Guest, Ajay R. Singh, President, V.N. Dubey, Rajesh L. Shah, Co-Chairman, Parag Ved, Hon. Treasurer, Harshal Bhuta, Convenor

Justice (Retd.) Shri Vishnu S. Koje, chief guest delivering keynote address. Seen from L to R: S/Shri Bhaumik Goda, Co-ordinator, Rajesh P. Shah, Chairman, Ajay R. Singh, President, Rajesh L. Shah, Co-Chairman, Harshal Bhuta, Convenor

Shri Hinesh Doshi, Vice-President, presenting memento to CA H. Padamchand Khincha

Shri Hinesh Doshi, Vice President, presenting memento to Shri K. K. Chythanya, Advocate

Shri T. P. Ostwal, Panellist, replying to the queries at the panel discussion. Seen from L to R: S/Shri Shabbir Motorwala, Hitesh Gajaria, Panellist, Saurabh Soparkar, Chairman of the session, Anish Thacker, Ramesh Iyer

12th Residential Conference on International Taxation, 2018
held from 21st June, 2018 to 24th June, 2018 at The Grand Bhagwati, Indore

CA Dilip Thakkar, addressing the delegates seen from L to R: S/Shri CA Hitesh Gajaria, Saurabh Soparkar, Sr. Advocate, Ajay R. Singh, President, CA T. P. Ostwal, CA H. Padamchand Khincha

Faculties

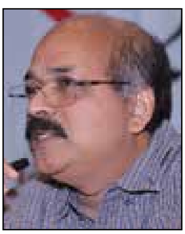
CA Dilip Thakkar

CA H. Padmacnahnd Khincha

K. K. Chythanya, Advocate

Hariharan Gangadharan, Advocate

Dr. Anup Shah

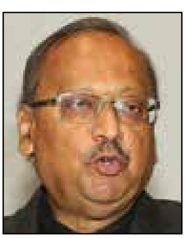


K. Vaitheeswaran, Advocate

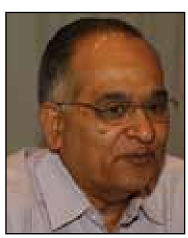
CA Pinakin Desai

CA Geeta Jani

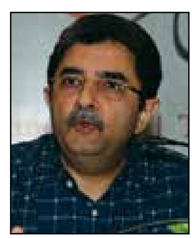
CA Rashmin Sanghvi



Saurabh Soparkar, Senior Advocate Chairman of the Panel Discussion replying to the queries



CA T. P. Ostwal panelist replying to the queries.



CA Hitesh Gajaria panellist replying to the queries

Shri Hinesh Doshi, Vice-President presenting memento to Shri Jawahar Andikattil, representative from DMCC, Dubai

CA Bhaumik Goda, Co-ordinator of conference giving final Vote of Thanks to the delegates, and faculty

12th Residential Conference on International Taxation, 2018
held from 21st June, 2018 to 24th June, 2018 at The Grand Bhagwati, Indore

Group Photo of the International Taxation Committee 2017-18

Group Photo of participants

91st AGM held on 4th July, 2018 at Garware Club House, Mumbai

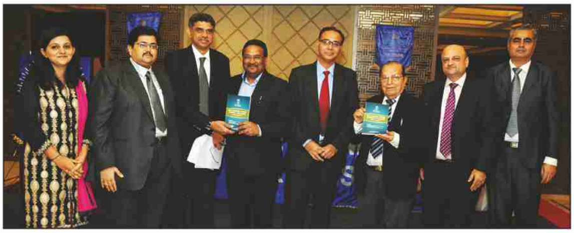
Seen from L to R: CA Vipul Choksi, Vice President, CA Hinesh Doshi, President, CTC, CA Sunil Gabhawalla, Vice President, BCAS, Shri Ajay R. Singh, Imm. Past President and CA Parag Ved, Hon. Jt. Secretary

Office Bearers of The Malad Chamber of Tax Consultants felicitating CA Hinesh Doshi, President, by offering bouquet.

Office Bearers of Goods and Services Tax Practitioners Association felicitating CA Hinesh Doshi, President, Elect by offering bouquet.

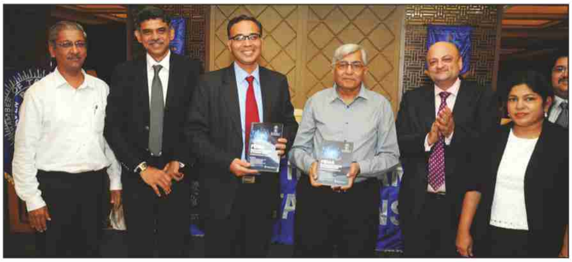
91st AGM held on 4th July, 2018 at Garware Club House, Mumbai

Book Release



Dr. Y. P. Trivedi, Past President and Sr. Advocate, releasing the publication on "Key Rulings under Indirect Tax Laws"

Dr. K. Shivaram, Past President and Sr. Advocate releasing the publication on "PMLA"



Shri Sahard Dalal, Past President releasing the publication on "FEMA"

Shri Ajay R. Singh, felicitating Shri Hinesh Doshi, incoming President by presenting bouquet

Dastur Essay Competition – 2018

The winners of the 7th Dastur Essay Competition, 2018 were felicitated by presenting a Mementos and Certificates

1st Winner Ms. Krisha Jitesh Sanghvi, from Hinesh R. Doshi & Co, LLP, Chartered Accountants was felicitated by S/Shri Ajay R. Singh, President and Shri Hinesh R. Doshi, Vice President

3rd Winner Mr. Meet Hiren Shah, from GBCA & Associates, Chartered Accountants, was felicitated by Shri Mahendra Sanghvi, Past President

9th Winner Mr. Sagar Khandelwal from Indira Gandhi National Open University, Jaipur was felicitated by Shri Vipin Batavia, Past President

Shri Narayan Pasari, President, BCAS felicitating Shri Hinesh Doshi, President and Shri Manish Sampat, Vice-President Elect, BCAS by presenting bouquet

Shri Sandeep Jain, Chairman, WIRC of ICAI felicitating Shri Hinesh Doshi, President by presenting bouquet

Shri Prafulla Chhajed, Vice President, ICAI felicitating Shri Hinesh Doshi, President by presenting bouquet

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