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THE CHAMBER'S JOURNAL

Vol. VII | No. 1 October 2018

YOUR MONTHLY COMPANION ON TAX & ALLIED SUBJECTS

A Monthly Journal of

The Chamber of Tax Consultants

Changes in Corporate Laws

Other Contents

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

Gateway to Professional Growth

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THE CHAMBER OF TAX CONSULTANTS
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Editorial

The month of October 2018 started with the Government deciding to step into the shoes of the management of the IL&FS. It was felt by the all concerned that if the IL&FS goes down, the tremors may be felt across the financial world and may even damage the mutual funds substantially. Looking at the seriousness of the situation, the Government has rightly decided to move in for damage control. It is interesting to note that this happens immediately after 10th anniversary of Lehman Brothers filing for their bankruptcy in the US. Lehman Brothers was the fourth largest investment banker in US. Bankruptcy suit of the Lehman Brothers was largest in terms of its asset value as it surpassed the asset value of earlier giants like Enron, Worldcom, etc., who had also filed for bankruptcy. It is said that Lehman Brothers bankruptcy is an outcome of the US subprime mortgage financial crisis. This incidence in US was followed by Satyam scam in January 2009 in India, which shattered the glass ceiling of corporate governance. At that time also the Government made a timely intervention and saved the company and the IT industry. Immediately thereafter the efforts to bring in the new legislation to deal with corporates intensified. Many objections of the professionals and professional bodies on that many provisions shall result into micro management of the corporates by the Government were brushed aside on the ground that we want to ensure that Satyam episode is not repeated. A Nelson's eye was turned on to the representations of the Professional bodies. Now, we are struck by the IL&FS crisis which is going to hurt the sentiment which is already pessimistic.

Infrastructure Leasing Financial Services Limited is, as the name suggests, a non-banking financial company. It is interesting to note that this entity lends to infrastructure projects and it carries on this operation through 300 entities in the form of subsidiaries, associates, joint ventures, etc. The business model is definitely not transparent, if it is not opaque. The IL&FS finances projects where the gestation period is long. The institutional shareholders like State Bank of India, LIC, HDFC didn't smell a rat and unfortunately credit rating agencies also failed to send a warning signal at the appropriate time. They junked the AAA rating only after the entity defaulted in its debt commitments. The IL&FS crisis has put everyone on notice, Government Regulators, credit agencies and professional bodies. We have to answer the Society how such a crisis happened in spite of the purported checks and balances. Have we failed in identifying the symptoms of the crisis or is it a scam? It is difficult for the common man to have any faith in the financial institutions and professional bodies. I AM REMINDED OF THE WORDS OF Fyodor Dostoevsky "A man who lies to himself, and believes his own lies, becomes unable to recognise truth, either in himself or in anyone else, and he ends up losing respect for himself and for others."

It is interesting that the Journal Committee has decided to come out with special story on Corporate Laws, which highlights the recent changes which have taken place. Eminent professionals have contributed to this issue. I hope the members will find it helpful while dealing with these issues. I thank all the contributors to this issue for taking their valuable time out of their busy professional schedule.

K. GOPAL
Editor

From the President

ἓν οἶδα ὅτι οὐδὲν οἶδα

"I know one thing, that I know nothing" – Socrates

After covering Sanskrit, Latin, Chinese language, we now come to another oldest language. Greek made its first appearance in 1450 BC and is a branch of the Indo-European language family. Its long history makes Greek one of the oldest among the languages spoken in Europe with about 34 centuries of documentation. The Greek alphabet on the other hand originated from the script used by the Phoenicians. Later, it became the source of the Gothic, Coptic, Armenian, Cyrillic and Latin systems of writing.

The month of October has several events and festivals. This 2nd October was celebrated as 150th year of **Mohandas Karamchand Gandhi (2nd October, 1869),** the **'Father of the Nation'.** The United Nations announced that October 2nd will be celebrated as the **International Day of Non-Violence,** a matter of great pride to all Indians worldwide.

Gandhiji had unconditional love for **'truth'** and **'duty'.** With his complete dedication and confidence, Gandhiji freed India from the British Rule and proved to the world that freedom can be achieved with non-violence. Even today his teachings encourage everyone to stay away from violence and find peaceful solutions to conflicts. For Gandhiji - Truth and non-violence was his entire philosophy of life.

He highlighted the seven 'Deadly Sins': 1 Wealth without work 2. Pleasure without conscience 3. Science without humanity. 4. Knowledge without character 5. Politics without principle 6. Commerce without morality 7. Worship without sacrifice.

Another eagerly awaited major Hindu festival in October is Navratri. Navratri literally means 'Nine Nights' and the festival is primarily dedicated to goddess Durga (symbol of power) who is worshipped in nine forms during the nine nights of Navratri. Members after completing their tax audits and return filing, should enjoy the festivities with enthusiasm and excitement of fasting, prayers, garba - dandiya and singing among other things to appease the goddess Durga.

The last day of Navratri – Dussehra, is celebrated with much fervour and gaiety. It is to celebrate the triumph of good over evil. So, **every year when you celebrate the Dussehra festival,** remind yourself to follow the path of dharma, truth and righteousness. Don't allow ego to influence your decisions. Listen to your inner voice that truth always wins.

In these challenging times with multiple deadlines and timelines, Members should take these opportunities to rejuvenate themselves by celebrating with family and friends.

In pursuance of our theme "Gateway to Professional Growth", The Chamber shall empower its members to navigate the challenges in everchanging landscape and web of new regulations, laws and compliances. Our economic environment is at its dynamic best with legislations and expectations growing on our profession.

CTC NEWS AND EVENT

The Chamber through its 14 committees is gearing up to deliver high quality programmes and has organised several marquee workshops, lecture meetings, webinars, seminars, etc. for its members and to name a few below.

The interaction and exchange of information across globe and within various tax departments in India has taken paradigm shift and new avenues of information have resulted in targeted scrutiny and reopening of several tax assessments. To guide our members to understand Rule of evidence and which of the information is legally admissible as evidence, **a Lecture meeting on "Rule of evidence with special reference to alleged suspicious transactions in shares"** was organised.

With over 100 countries now part of BEPS Inclusive framework and 80+ countries signing on the dotted line of MU, we successfully announced first ever **Certificate Course on MULTILATERAL INSTRUMENTS** spread over four days covering entire gamut of BEPS Actions Plans released by OECD. The inauguration of the Course was done by **Mr. A. A. Shanker, Principal Chief Commissioner of Income Tax, Mumbai,** and **Mr Hemant Kumar Sarangi, Chief Commissioner of Income Tax (International Taxation), West Zone** and appreciated the forward looking approach of Chamber to organise such Course.

October 1 to 7 is World Investor Week (WIW). This global campaign is promoted by Organisation of Securities Commission (IOSCO) to raise awareness about importance of investor education and protection. With tremendous buoyancy and fluctuation in equity markets, Chamber organised first Capital Market Study Circle Meeting on **"Emerging trends in Equity market in these turbulent times"** to understand current scenario and to navigate in such turbulent times.

We also organised meeting on **"Taxation Trends in Digital Economy and E-commerce"** to understand tax challenges and intricacies of cross border taxation and PE issues.

The Industry and Professional were eagerly awaiting new Form of Annual Return and GST Audit Report. The CBIC has finally notified both Returns and Audit Report format. Chamber has timely planned half day **"Workshop on GST Annual Return and GST Audit Report"** and have seen record enrolments and attendance. The due date of 31st December looks difficult target for most professionals to achieve and necessary representations will be made to CBIC for extension of due date.

Finally, The Chamber has announced both **Residential Refresher Conference of GST** in January, 2019 at Hotel Novotel, Hyderabad and **Residential Refresher Conference of Direct Taxes at Lucknow** in February, 2019. Please register at the earliest to avail benefit of super early bird offer, which shall be closing very shortly. Please refer to Chambers website to review entire programme of both RRCs with topics, rates and speakers. Please book your air tickets in advance for both RRCs.

REPRESENTATIONS

Chamber played an active and catalyst role in pursuing CBDT to extend due date to file Tax Audit and Returns to 15th October, 2019. This extension has given major relief to Chartered Accountants to complete their assignments.

We also along with Indian Merchants' Chamber of Commerce and Industry and Bombay Chartered Accountants Society met Mr. A. A. Shankar, Principal Chief Commissioner of Income Tax, Mumbai, to discuss ground level issues faced by tax payers and hold round table meeting in near future to discuss them.

Very few copies of recently launched Publications are available. Members are requested to buy copies before it is sold out.

I thank Authors for contributing on current month theme of journal on "Changes in Corporate Law" and special thanks to Mr. Makarand Joshi and Mr. Sanjeev Shah for designing this month's issue to cover all amendments and changes. My special thanks to Journal Committee and Editorial Committee to select topical subjects as theme for each Journal, which is very well appreciated by Members and readers.

We welcome Members to send their feedback, suggestions and observations for any matter related to the Chamber by sending e-mail on office@ctconline.org or hineshdoshi67@gmail.com.

Life is like a piece of embroidery. A perfect design can be made only when we happily tolerate the mess of knots and frays on the underside.

ευχαριστώ ***(Thank you)***

Hinesh R. Doshi
President

The Chamber of Tax Consultants

Vision Statement

The Chamber of Tax Consultants (The Chamber) shall be a powerhouse of knowledge in the field of fiscal laws in the global economy.

The Chamber shall contribute to the development of law and the profession through research, analysis and dissemination of knowledge.

The Chamber shall be a voice which is heard and recognised by all Government and Regulatory agencies through effective representations.

The Chamber shall be pre–eminent in laying down and upholding, among the professionals, the tradition of excellence in service, principled conduct and social responsibility.

 

CS Anshul Jain and CS Anshu Agarwal[1]

Recent Changes in Annual Return and Board's Report

The Companies (Amendment) Act, 2017 ("CAA, 2017") received the assent of the President in January 2018. Since then there have been numerous commencement notifications for bringing into force the various amendments introduced by the CAA, 2017 and notifications to amend various rules made under the Companies Act, 2013 ("the Act") by the Ministry of Corporate Affairs ("MCA").

The CAA, 2017, *inter alia*, amended sections 92 and 134 of the Act and therefore, it is necessary for the companies to understand the impact of the said amendments on the Board's Report and Annual Return. However, it is to be noted that amendment to the provisions of section 92 is not yet notified whereas amendments to section 134 have been notified. The corresponding amendments in the Companies (Accounts) Rules, 2014 have also been introduced.

One of the very important amendments with regard to annual return has been made in section 403 which mandates the payment an additional fee of ₹ 100 per day for each day of default for non-filing of annual return after expiry of its due date of filing. The said provision has been already notified *vide* notification dated May 7, 2018 and made applicable for the filing of annual returns of past years and of the current year with effect from July 1, 2018. The corresponding changes have also been made in sections 92(4) and 92(5) of the Act, dealing with a due date for filing of annual return by the companies with the Ministry of Corporate Affairs. Before the amendments in section 92 of the Act read with section 403 of the Act, the companies had an additional time period of 270 days from the expiry of the initial time period of 60 days for the filing of an annual return with additional fees without any liability of any legal action under the Act. As per the amendments brought in sections 92(3) and 92(4) read with section 403 of the Act, apart from payment of additional fees, companies may also be liable to face legal action for filing the annual return after the due date of filing.

The CAA, 2017 has brought in the following changes in section 92 of the Act dealing with annual return:

Details of indebtedness

The requirement of giving details relating to indebtedness has been omitted as the same is

1 The views expressed by the authors are personal.

already part of the financial statement of the same period to which the annual return relates and therefore to avoid the duplication of the information, this has been omitted. However, it is yet to be notified and hence, still forming part of Form MGT-7 i.e., a form of annual return.

Details of Foreign Institutional Investors

Presently, a company is required to provide the details in respect of shares held by or on behalf of the foreign institutional investors indicating their names, addresses, countries of incorporation, registration and percentage of shareholding held by them. There were practical difficulties faced by the companies to obtain all the information mentioned in the clause and hence the section has been amended and going forward, the companies will be required to disclose the details only in respect of shares held by or on behalf of the foreign institutional investors. The other details like names, addresses, countries of incorporation, registration and percentage of shareholding held by the foreign institutional investors will not be required to be disclosed. The said amendment is yet to be notified.

Abridged form of Annual Return for certain classes of Companies

One of the significant amendments made in the provisions of section 92 of the Act is that now the Central Government has got the power to prescribe the abridged form of annual return for One Person Company, Small Company and such other class or classes of companies as may be prescribed. This will give a big relief to Small Companies and One Person Companies. It is expected that the Central Government will notify the new forms of annual return for Small Companies and One Person Companies with minimum information.

Extract of annual return

At present an extract of annual return in form MGT-9 as prescribed under Rule 12 of Companies (Management and Administration) Rules, 2014 is required to be annexed to the Board's report. The Company Law Committee ("CLC") in its report[2] had recommended that this requirement may be omitted and instead the web address/link of the annual Return, hosted on its website, if any, should be provided in the Board's Report. Based on the above recommendation, section 92(3) of the Act, has been amended. As per the amended provisions, companies are required to place a copy of the annual return on the website of the company, if any, and the weblink of such annual return shall be disclosed in the Board's report. Once the notification of commencement of the said amendment is issued, the requirement of preparation of Form MGT-9 will be done away with. However, there will be certain clarifications required with regard to the proposed requirement as the Board's Report is approved much before the filing of annual return and there is certain information such as date of annual general meeting, attendance of director related information at such meeting, etc., which cannot be provided in the annual return at the time of approval of the Board's Report.

Disqualification for non-filing of annual return

Section 164(2) of the Act *inter alia* states that a person who is or has been a director of a company which has not filed financial statements or annual returns for any continuous period of three financial years will be disqualified for re-appointment/appointment as mentioned in the said section. However, it is now also mentioned in the said section that where a person is appointed as a director of a company which is in default of section 164(2) of the

2. CLC Report issued in February 2016

Act, he shall not incur the disqualification for a period of six months from the date of his appointment to avoid paradoxical situation of new person appointed as a director also getting disqualified as a director and thereby required to vacate the office of director.

Now let us see the changes introduced by CAA, 2017 in section 134 of the Act dealing with the Board's Report. CLC in its report cited that the several suggestions were received that due to the numerous disclosures in the Board's Report, the Report had become lengthier and more expensive to produce. Based on the suggestions received, CLC had recommended some amendments in section 134 of the Act. The amendments made by the CAA, 2017 in section 134 of the Act are being discussed hereunder. These amendments have already been notified with effect from July 31, 2018 and hence, applicable to Board's Reports approved on and after July 31, 2018.

Web address of annual return

The companies will now be required to mention the web address, if any, where annual return referred to in section 92(3) of the Act has been hosted instead of attaching the extract of annual return in Form MGT-9 to the Board's Report. However, since provisions of section 92(3) of the Act are not yet notified, it is advisable to enclose Form MGT-9 in Board's Report and also to give web address, if any, where the annual return is hosted.

Performance Evaluation

Section 134(3)(p) of the Act has been amended to align it with section 178 of the Act as amended by CAA, 2017. As per the amended provisions, a statement indicating the manner in which formal annual evaluation of the performance of the Board, its Committees and of individual directors have been made is required to be given in the Board's Report of every listed company or public companies having paid-up share capital of ₹ 25 crore or more. As per the earlier sub-section, the disclosure pertained to how the evaluation was done by the Board of its own performance and of its committee and individual directors. Since as per revised section 178, the performance evaluation can be done either by the Board, by the Nomination and Remuneration Committee or by an independent external agency, the reference of evaluation by the Board has been deleted and instead a disclosure on the manner of evaluation has been inserted.

Repetitive Disclosures

CLC stated in its report that repetitive disclosures needs to be harmonised so that the Report is structured, repetition is avoided and made more readable. Therefore, it is added in section 134 of the Act that where disclosures referred to in section 134(3) of the Act have been included in the financial statements, such disclosures shall only be referred to instead of being repeated in the Board's report.

Reference of Policies

There is a relaxation provided in section 134 of the Act with regard to enclosing of company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under section 178(3) of the Act and the details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year in Board's Report. It is now stated that if the above policies are made available on company's website, if any, it shall be sufficient compliance of the above requirements if the salient features of the policy and any changes therein are specified in brief in the Board's Report and the web address is indicated therein at which the complete policy is available. The corresponding amendment has also been made in section 178 of the Act in this regard. As per the language of the amended sub-section, it can be concluded that the said exemption shall be available only for the companies which have a website and the said policies have been uploaded on the website of the company.

Abridged Board's Report

One of the recommendations made by CLC in its report was to prescribe a separate format of the Board's Report for Small Companies. Based on the same, section 134(3A) of the Act has been added in section 134 which states that the Central Government may prescribe an abridged Board's Report for the purpose of compliance with this section by One Person Company or Small Company. The MCA *vide* its notification dated July 31, 2018 amended the Companies (Accounts) Rules, 2014 and added Rule 8A in the same which has prescribed 11 disclosures in the Board's Report of Small Companies and One person Companies, as under:

a) the web address, if any, where annual return referred to in section 92(3) of the Act has been placed;

b) number of meetings of the Board;

c) Directors' Responsibility Statement as referred to in section 134(5) of the Act;

d) details in respect of frauds reported by auditors under section 143(12) of the Act other than those which are reportable to the Central Government;

e) explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the auditor in his report;

f) the state of the company's affairs;

g) the financial summary or highlights;

h) material changes from the date of closure of the financial year in the nature of the business and their effect on the financial position of the company;

i) the details of directors who were appointed or have resigned during the year;

j) the details or significant and material orders passed by the regulators or courts or tribunals impacting the going concern status and company's operations in future;

k) the particulars of contracts or arrangements with related parties referred to in section 188(1) of the Act in the Form AOC-2.

It is to be noted that it is specifically mentioned in newly added section 134(3A) of the Act that *"for the purpose of compliance with this section"* and therefore, in case, if any other section of the Act or any other law applicable to such companies mandates to disclose some other information in Board's Report, the same would also be required to be disclosed apart from these 11 disclosures to ensure compliance of other sections.

Affirmation of applicability of maintenance of cost records

As per the amendment in Rule 8 of the Companies (Accounts) Rules, 2014, made effective from July 31, 2018, every company has to give a disclosure in the Board's report as to whether it is required to maintain cost records as per the provisions of section 148 of the Act read with Companies (Cost Records and Audit) Rules, 2014 and companies which have been mandated to maintain cost records also have to give an affirmation stating that such cost accounts and cost records have been maintained by the company.

Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013

Another important amendment in the Companies (Accounts) Rules, 2014 effective from July 31, 2018, mandates that in the Board's Report, a statement that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013 should also be given.

As per section 4 of the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, every employer of a workplace has to constitute a committee to be known as the "Internal Complaints Committee". As per the request of the Ministry of Women and Child Development, the companies have now been mandated to give a disclosure stating that the company has complied with provisions relating to the constitution of Internal Complaints Committee under the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013. It should be noted that the said disclosure is applicable to all the type of companies irrespective of whether the company has any women employees on its rolls or not.

Prior to the amendment of CAA, 2017, as per section 22 of the Sexual Harassment of Women at Workplace (Prevention, Prohibition and Redressal) Act, 2013, the companies were required to make disclosure only about the details of number of cases of sexual harassment filed during the year and status of their disposal in their annual report.

It is important to note that as per section 26 of the said Act, if the companies are convicted for the second time for the same offence, they would also be liable for cancellation or withdrawal of licence or non-renewal or non-approval or cancellation of the registration required for carrying on its business or activity.

Disclosure as per revised Secretarial Standard-1 (SS-1)[3]

As per para 9 of the revised SS-1, the Report of the Board of Directors is required to include a statement on compliance of applicable Secretarial Standards. At present two secretarial standards viz., SS-1 with regard to Meetings of the Board of Directors and SS-2 with regard to General Meetings are mandatorily applicable. Guidance note of SS-1 has provided a suggested draft in this regard, as *"the Directors have devised proper systems to ensure compliance with the provisions of all applicable Secretarial Standards and that such systems are adequate and operating effectively."*

Conclusion

Since the introduction of the Act, the intent of the MCA has always been to shift the corporates to disclosures regime with lesser regulatory interference and greater self-regulation. Hence, it is the responsibility of the corporate citizens to be on the right side of the law in letter and spirit. With this, they will always be avoiding the penal consequences.

❍❑❍

3. Revised SS-1 is effective from October 1, 2017

The brain and muscles must develop simultaneously. Iron nerves with an intelligent brain – and the whole world is at your feet.

— *Swami Vivekananda*

Atul Mehta, *Company Secretary*

Important Aspects of Company Formation

Introduction

A company is a legal entity formed by a group of individuals to engage in and operate a business enterprise. A company may be organised in various ways for tax and financial liability purposes depending on the corporate law of its jurisdiction.

Registration of a company

Company registration means legally getting the right to do business. In India, registration of company is also known as formation of business or incorporation of company.

Types of Business Entities in India

Types of Companies in India – Types of Corporate Entities in India – Types of Legal Entities in India – Options for Foreign Investors Doing Business in India

In India, the following types of business entities are available:

- Private Limited Company
- Public Limited Company
- Unlimited Company
- Limited Liability Partnership (LLP)
- Partnership
- Sole Proprietorship
- Liaison Office / Representative Office
- Project Office
- Branch Office
- Joint Venture Company
- Subsidiary Company

Both the Indian promoters and the foreign promoters can form the following business entities: Private Limited Company, Public Limited Company, Limited Liability Partnership, Unlimited Company, Partnership and Sole Proprietorship. The foreign companies also have the options of forming the following type of business entities: Liaison Office/Representative Office, Project Office, Branch Office, and Joint Venture Company. It must be noted that a Joint Venture Company is not a separate type of legal entity; it could be either a Private Limited Company, a Public Limited Company, or an Unlimited Company. Similarly a wholly owned Subsidiary of a foreign company in India could be either a Private Limited Company, a Public Limited Company, an Unlimited Company, or a Branch Office.

For a foreign Investor in India it is very important to choose a right kind of business or corporate entity which best suits its purposes and takes care of liability issues and tax planning issues. Foreign Companies planning to do business in India should pay special attention to Entry Strategies in India for Foreign Investors and corporate structuring to save taxes to the best extent allowed by laws and international tax treaties.

It may be required for foreign investors or foreign shareholders, both individuals and corporate shareholders, to seek Government Approvals for Investing in India In some special cases Foreign Investment Promotion Board, FIPB Approval for Foreign Investment in India is required. In other cases Reserve Bank of India, RBI Approvals for Foreign Investment in India is required. The sectors where RBI Approval for foreign investors is available under automatic route can be found at FDI in India Sector wise Guide.

There are various steps required to establish a business in India, before and after incorporation, as mentioned hereinafter. See also the Procedure for Formation of Company in India.

A Company in India can have foreign directors provided some conditions are fulfilled. The directors of an Indian company, both Indian and foreigner directors, are required to obtain Director Identification Number – DIN and Digital Signature Certificate – DSC.

There are some restrictions regarding issuing sweat equity for a company incorporated in India.

Private Limited Company

A private company is a company which has the following characteristics:

- shareholders right to transfer shares is restricted;
- the number of shareholders is limited to 200; and
- an invitation to the public to subscribe to any shares or debentures is prohibited.

A Private Limited Company is the most popular form of business entity used for Foreign Investors in India, including USA investors in India. There are various requirements for forming a private limited company in India. There are various steps required to establish a business in India, before and after incorporation, as mentioned hereinafter.

Public Limited Company

A public company is defined as a company which is not a private company. The following conditions apply only to a public company:

- It must have at least seven shareholders.
- A public company is not authorised to start business upon the grant of the certificate of incorporation.
- A public company is required to have at least three directors.
- It must hold statutory meetings and obtain government approval for the appointment of the management.

There are several other provisions contained in the Companies Act which are applicable only to public companies and should be consulted.

Liaison Office / Representative Office

A Liaison Office could be established with the approval of the Government of India. The role of Liaison Office is limited to collection of information, promotion of exports/imports and facilitate technical/financial collaborations.

Liaison office cannot undertake any commercial activity directly or indirectly.

Project Office

Foreign companies planning to execute specific projects in India can set up a temporary project/ site offices in India for carrying out activities only relating to that project. The Government of India has now granted general permission to foreign entities to establish project offices subject to specified conditions.

Branch Office

Foreign companies engaged in manufacturing and trading activities abroad are allowed to set up Branch Offices in India for the following purposes:

- Export/Import of goods
- Rendering professional or consultancy services
- Carrying out research work, in which the parent company is engaged
- Promoting technical or financial collaborations between Indian companies and parent or overseas group company.
- Representing the parent company in India and acting as buying/selling agents in India
- Rendering services in Information Technology and development of software in India
- Rendering technical support to the products supplied by the parent/ group companies.
- Foreign airline/shipping company.

A branch office is not allowed to carry out manufacturing activities on its own but is permitted to sub-contract these to an Indian manufacturer. Branch Offices established with the approval of RBI, may remit outside India profit of the branch, net of applicable Indian taxes and subject to RBI guidelines Permission for setting up branch offices is granted by the Reserve Bank of India (RBI).

Joint Venture Company

A joint venture is a temporary business association between two or more persons or organisations for profit without forming a permanent partnership, corporation, or other business entity. Members of the joint venture maintain their independence.

Subsidiary Company

A subsidiary, subsidiary company or daughter company is a company that is owned or controlled by another company, which is called the parent company, parent, or holding company. The subsidiary can be a company, corporation, or limited liability company. In some cases it is a government or state-owned enterprise.

Incorporation of Companies

Incorporation and management of companies in India has come a long way. The year 2013 marked a significant landmark with introduction of the new Companies Act, 2013. The idea behind this new law was to ease the process of setting up a company and providing a more transparent legal system to the new generation of entrepreneurs.

As a start-up, the company has two alternatives to incorporate the business organisation as - Private Limited Company or One Person Company. Forming a public limited company, on the other hand, requires higher capital, directors, legal compliances and set up costs.

Incorporation of Companies is governed by Chapter 2 of the Companies Act, 2013. The Ministry of Corporate Affairs (MCA) has introduced a new set of forms to register a company named SPICE or Simplified Proforma for Incorporating Company Electronically. MCA has been consciously focusing on easing the process of incorporation for companies to achieve their goal of improving ranks in Ease of Doing Business Report of World Bank.

The Companies (Incorporation) Fifth Amendment Rules, 2016 replaced e-forms INC-7 and/or 29 along with set of other e-forms with SPICE INC-32 form series. This became effective from January 1, 2017.

Procedure for incorporation of a company with spice Form – Inc 32

The SPICE or Simplified Proforma for Incorporating Company Electronically via e-form INC-32.

Thus, the focus is only on SPICE e-form series for explaining the incorporation process.

Hence, Private Limited Companies/OPC can be converted into Public Limited Company at any point in time as and when the business grows, hence, it's better to stay privately held till such time.

The Ministry of Corporate Affairs (MCA) has introduced a major reform for entrepreneurs in India. Now made the Incorporation Process easier and faster by way of introducing SPICE Form – INC 32.

This e-Form is accompanied by supporting documents including details of directors & subscribers, Memorandum of Association (MOA) **(through Linked Form INC 33**)** and Articles of Association (AOA) **(through Linked Form INC 34**)** etc. Once the e-Form is processed and found complete, company would be registered and Company Identification Number (CIN) (i.e., Company Registration Number) would be allocated along with Director Identification Number (DIN) to the proposed Directors (to whom do not have a valid DIN).

We can apply maximum three DIN Applications for the proposed Directors by using this integrated form.

Along with the allocation of CIN and DIN, now MCA has introduced the Application for Permanent Account Number (PAN) and Tax Assessment Number (TAN) for the Company. While making the application for Company Registration through SPICE Form 32, it is only required to enter the details of jurisdiction of the Company i.e. Area and Ward / Circle of the Income Tax Office within which jurisdiction the Registered Office of the Company falls under. MCA will allot PAN and TAN to the Company along with the Certificate of Registration. Hence, the promoters need not require to make the separate applications for obtaining PAN and TAN on the name of the Company.

*** SPICE Form 33 (MOA) and SPICE Form 34 (AOA) cannot be used in case there are Foreign Promoters / First Subscribers / Shareholders of the Company.*

So, following are the steps involved for Company Registration through SPICE.

Step 1: Name reservation through "Run" service (Reserve Unique Name):

RUN (Reserve Unique Name) Service of Companies Act, 2013.

MCA has introduced a Simplified Procedure for Reservation of Company Name. RUN is a Web based Application in which it is required to provide only few details i.e., Type of Company, New / Existing Company, Proposed Company Name and Comments, if any. With these details, we can apply for Reservation of proposed Company Name and for this Application there is no need for having digital signature of the Applicant. A person having a valid MCA User ID and Password, can apply for the Company Name Reservation.**

NOTE : A person will be considered as an Applicant of which the User ID, the Name Reservation Application has filed and MCA will issue Name Approval Letter on the name of such Applicant/ Person only. Therefore, we create the New User ID for the Company, on the name of any promoter, accordingly the Name Approval Letter will be on the name of any the promoter of the Company.

Details required

1. Six proposed names **(Need to check availability with Ministry of Corporate Affairs.)**
2. Main objects of the proposed Company
3. If the proposed Company Names includes the words such as Insurance, Bank, Stock Exchange, Venture Capital, Asset Management, Nidhi, or Mutual Fund etc., then undertaking from the promoters is required.
4. If the proposed name is registered with trademark, then copy of Trademark Certificate along with NOC from the owner is required.
5. In case of an Indian Company being a Subscriber, the Company shall authorise one of its Director/Authorised person to sign and subscribe to the Memorandum and Articles of Association by way of Board Resolution.
6. In case of a Foreign Company being a Subscriber, the Company shall authorise one of its Director/Authorised person to sign and subscribe to the Memorandum and Articles of Association by way of Board Resolution duly attested by competent Authority in Home Country.

NB

1] We can provide 2 Proposed Name Options in preferential order. In case, MCA reject the options applied for, we can resubmit the Form again with another 2 Name options. Here, please note that MCA will provide only 1 time resubmission, post which the application will get rejected.

2] Approved Name will be valid for 20 days only from the date of approval, within which the entire process of Company Registration required to be completed.

Step 2: Obtaining digital signature for Indian Directors and Subscribers

MCA has made the Company Registration process easier as well as digital. Therefore, every promoter (i.e. Subscribers / First Shareholders to the Memorandum & Articles of Association) need to have a digital signature.

Following are the requirements :

1. DSC application must be signed on the 1st page and across the photograph.
2. Self-attested copy of PAN card as proof of identity.
3. Self-attested copy of Address proofs like passport, election (voter identity) card, driving licence, electricity bill, telephone bill or bank account statement **(certified by Bank)** or any utility bill as specified in the Form shall be attached and should be in the name of applicant only.

   Address proof i.e., utility bill and Bank Statement shall not be older than 2 months from the date of submission of the form. **(ANY ONE)**
4. Validity of the same will be for 2 (TWO) years.
5. Email ID, Mobile No. and Telephone No. is mandatory.

NB:

Copy of self-attested PAN card is mandatory for PAN encrypted DSC.

Certificate is directly issued in token and hence, PFX file will not be issued.

All signatures should be done in blue pen only.

Obtaining digital signature for foreign directors and subscribers

1. DSC application must be signed on the 1st page and across the photograph in blue ink only.

2. Copy of Passport is mandatory as Identity proof.

3. Address proofs like passport (if address mentioned), driving licence, electricity bill, telephone bill or bank account statement (certified by Bank) or any utility bill in the name of applicant only. Address proof shall not be older than 3 months from the date of filing of the form.

4. Attestation of identity and address proofs along with application form in blue ink only:

   a) If a foreign national residing in native country attestation must be done as follows:

      i. If native country is a signatory of Hague Convention, then the supporting documents including the Form and photo must be notarised by Public Notary and apostiled by the competent authority.

      ii. If native country is not a signatory of Hague Convention, then the supporting documents including the Form and photo must be notarised by Public Notary and Consularised by the competent authority.

5. If a foreign national is residing in India, then following documents along with identity and address proof must be attested by individual's Embassy:

   i. Resident Permit certificate issued by Assistant Foreigner Regional Registration officer (FRRO), an officer of Bureau of Immigration of India

   ii. Passport and Visa

   iii. Application form with photo

6. If a foreign national neither resides in India nor in native country, then the following documents along with address identity and address proof must be attested by the local Embassy to which the applicant belongs to:

   i. Passport

   ii. Visa

   iii. Application form with photo

7. Validity of the same will be for 2 (TWO) years.

8. Unique e-mail ID (personal)

9. Mobile No. and Telephone No. is mandatory.

Step 3: Drafting, stamping and filing of company incorporation documents:

AFTER RECEIPT OF NAME APPROVAL, THE COMPANY SHOULD BE INCORPORATED WITHIN 20 DAYS FROM THE DATE OF APPROVAL BY FILING SPICE FORM INC 32 (INCORPORATION FORM) ALONG WITH MOA & AOA AND OTHER REQUISITE DOCUMENTS.

1. Application for DIN IDENTIFICATION NUMBER maximum 3 (three) applications. *(Only for those Directors, who do not have DIN at the time of Company Registration)*

Documents/Details required

a) Identity Proof **(ANY ONE)**

   i. Copy of PAN Card duly self attested, mandatory for Indian Nationals.

   ii. Copy of Passport is mandatory in case of foreign individual.

iii. Copy of Passport / Driving Licence / Election (voter) ID, duly self attested.

b) Address Proof **(ANY ONE)**

i. Copy of Bank Statement / Electricity Bill / Telephone Bill / Mobile Bill. The same shall be on the name of the Promoter/Director and should not be older than two months.

ii. Proofs other than language in Hindi/English must be translated from professional translator carrying his details (name, signature, address) and seal and notarised.

NOTE : In case of the foreign individual / entity, who are the promoters in Indian Company, their ID and address proofs required to be attested by the Consulate of Indian Embassy or Foreign Public Notary along with Apostilisation.

c) **Other details as per the requirements of the e-Form INC 32, E-Form INC 33 and E-Form 34.**

1. State and Place in which the proposed company to be Registered.

2. Proposed Authorised Capital. (suggested to keep minimum of ₹ 1 lakh)

3. Proposed Paid up Capital. (Suggested to keep minimum of Rupees Ten Thousand)

4. Declaration from Practising Professional for validity of the documents of the Incorporation and verifying the details of subscribers in prescribed Form INC-8.

5. Declaration from Subscribers and Directors in prescribed Form INC-9.

6. Declaration by the Directors – As per provisions of the Companies Act, 1956, RBI Act 1934 and SEBI Act 1932 – for not accepting deposits.

7. Consent in prescribed Form DIR-2 from the individuals who will be the First Directors of the proposed company.

8. Proof of Registered Office address (Conveyance/Lease deed/Rent Agreement along with the rent receipts) etc. Also required address of nearest police station within which jurisdiction the registered office of the Company will be situated (mandatory).

9. Copies of the utility bills i.e., Telephone Bill / Electricity Bill / Gas Bill / Mobile Bill, as an additional proof of registered office address for confirmation (**Mandatory**).

10. No objection certificate that the Company is permitted to use the address as the registered office of the company if the same is owned by any other entity/ Person (not taken on lease by company) (Mandatory).

11. In case of Indian Subscribers, E-MoA (Form INC-33) and E-AoA (Form INC-34) required to be digitally signed by all the subscribers. Hence, need digital signatures of the subscribers.

12. In case the foreign subscriber, signing the shares subscription pages of MOA and AOA outside India, his/her signature and details required to be Apostile in home country or duly attested by Indian embassy of that country. After arrival of attested documents in India, stamping will be done and then other Indian subscribers will sign the documents. If foreign subscribers are signing subscription pages of MOA and AOA in India, need copy of passport along with proof of immigration

date which is required to be attached in spice form INC-32.

13. A witness to the subscribers of E-MOA and E-AOA should be same who will be certifying the e-Forms of the Incorporation i.e., Practising Professional only.

Corporate Documents for Registration of a Company

For incorporating a company in India, an application for registration should be submitted to the registrar of companies with the following documents:

1. Memorandum of Association
2. Articles of Association
3. A declaration signed by a person named in the Articles of the proposed company as a director, manager, or secretary of the company, or by an advocate of the Supreme Court or High Court, or by an attorney entitled to appear before the High Court, or by a chartered accountant practicing in India stating that all the requirements of the Companies Act 1956 and the applicable rules with respect to the registration and other matters have been complied with;
4. Affidavits from subscribers;
5. A list of persons who have consented to act as directors of the company.
6. If the proposed company is a public company, consent of very person prepared to act as a director must be submitted in a prescribed form;
7. Information about directors, managing directors and managers and secretary must be submitted in a prescribed form;
8. Information about the registered office in a prescribed form;
9. Power of attorney in favour of one of the promoters or any other person, authorising him/her to make corrections in the documents submitted to the registrar of the companies, if it becomes necessary; and
10. Applicable registration fee payable to the registrar of the companies.

Applicable Laws for Forming a Company in India

The laws applicable for incorporating a company in India include the India Companies Act 2013, read with Companies (Central Governments') General Rules and Forms, the Indian Income-tax Act, and other laws & regulations. The previous law was India Companies Act of 1956.

The Foreign Exchange Management Act of 1999 is applicable for foreign investments and transactions.

Where to Incorporate in India?

A company incorporated in any State of India can do business in all the States of India. The following are the locations of Registrars of Companies (ROC's) in India:

States & U.T.'s of India	ROC Locations
Delhi & Haryana	Registrar of Companies Delhi & Haryana, New Delhi
Karnataka	Registrar of Companies Karnataka, Bangalore
Maharashtra, Dadra & Nagar Haveli	Registrar of Companies Maharashtra, Mumbai (Bombay)

States & U.T.'s of India	ROC Locations
Pune, Kolhapur, Ratnagiri, Satara, Sindhudurga, Sangli, Sholapur & Ahmednagar districts in Maharashtra	Registrar of Companies Pune, Pune
Tamil Nadu	Registrar of Companies Tamil Nadu, Chennai (Madras)
Coimbatore, Nilgiris, Periyar Salem, Dharmapuri & Dindigul, Quaid-e-Milleth districts in Tamil Nadu	Registrar of Companies Coimbatore, Coimbatore
Gujarat	Registrar of Companies Gujarat, Ahmedabad
Andhra Pradesh	Registrar of Companies Andhra Pradesh, Hyderabad
Assam, Tripura, Manipur, Nagaland, Meghalaya, Arunachal Pradesh, Mizoram & Shillong	Registrar of Companies Assam, Tripura, Manipur, Nagaland, Meghalaya, Arunachal Pradesh, Mizoram & Shillong, Shillong
Bihar & Jharkhand	Registrar of Companies, Patna
Goa, Daman & Diu	Registrar of Companies Goa, Daman & Diu, Goa
Jammu & Kashmir	Registrar of Companies Jammu & Kashmir, Jammu & Srinagar
Kerala, Amindivi, Minicoy & Lakshadweep Islands	Registrar of Companies Kerala, Cochin
Madhya Pradesh & Chhattisgarh	Registrar of Companies Madhya Pradesh, Gwalior
Orissa	Registrar of Companies Orissa, Cuttack
Pondicherry	Registrar of Companies, Pondicherry
Punjab, Himachal Pradesh & Chandigarh	Registrar of Companies Punjab, Himachal Pradesh & Chandigarh, Jalandhar
Rajasthan	Registrar of Companies Rajasthan, Jaipur
Uttar Pradesh & Uttaranchal	Registrar of Companies Uttar Pradesh, Kanpur
West Bengal	Registrar of Companies West Bengal, Calcutta (Kolkata)
Andaman	The Registrar of Companies Andaman, Port Blair

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Mahavir Lunawat, *Company Secretary*

Section 42 of Companies Act, 2013 – A surge towards enhanced Governance Major changes in fund raising provisions (Private Placement)

Gone are the days when statutory compliances were considered trivial and were particularly ignored by masses. Since institution of Companies Act, 2013 ('the Act') and Rules made thereunder, there has been a constant feud between the law makers and the readers. Recent amendments aim to harmonise laws with fair practices in the interest of all the stakeholders.

Understanding Private Placement

As the name suggests, private placement is method of raising funds from a private pool of identified investors. Public at large cannot participate in private placement offerings. It is one of the elementary methods for fund raising for private companies who face challenges to approach public for capital or banks for loans to service their funding requirements.

Section 42 of Companies Act, 2013 defines Private Placement as "any offer or invitation to subscribe or issue of securities to a select group of persons by a company (other than by way of public offer) through private placement offer-cum-application, which satisfies the conditions specified in section 42 of the Act".

Section 42 of Companies Act, 2013 and Companies (Prospectus and Allotment of Securities) Rules, 2014 deals with issue of securities on private placement basis. On August 7, 2018 Companies (Amendment) Act, 2017 were notified which have made norms more stringent and has been able to fix some patches that erstwhile Companies Act, 1956 had. Under the 1956 Act, the conditions relating to private placement were applicable only to public companies, however now conditions for private placement apply to both private companies and public companies.

Since, private placement is further issue of capital, a company making private placements must also comply with section 62 of the Companies Act, 2013. There haven't been major amendments in section 62.

Impact Analysis

Let us understand major changes in fund raising through private placement under section 42 with its clauses one by one.

Applicability

[Section 42(1)] The section applies to private placement of "securities". As per section 2 (81), "securities" means securities as defined under Securities Contracts (Regulation) Act, 1956. Hence the section not only applies to shares and debentures but also to stocks, bonds, or other marketable securities, derivative, units or any other instrument issued by any Collective Investment Scheme (CIS), security receipt, rights or interest in securities. **Issue of debt securities by way of private placement would also require additional compliance with respect to approvals and borrowing limits under Section 180(1)(c) of the Act.**

Under the Act, 1956, only issue of shares and debentures were covered. This increase in scope shall bring parity between the Act and SEBI laws.

Identified person & Subscribers

[Section 42(2)]: The board of directors of the company have to identify select group of persons ("identified person") to whom private placement is proposed. The name and address of the identified person shall be recorded by the Company. **The board of directors are therefore required to expressly mention the name of persons to whom the offer is proposed. This shall bring better transparency to the shareholders in identifying the source of funds and value at which the security is offered a particular person or group of persons.**

The number of such persons shall not exceed two hundred as specified under Rule 14 of Companies (Prospectus and Allotment of Securities) Rules, 2014. Erstwhile law had a limit of fifty allottees. **The threshold of maximum two hundred allottees in a "financial year" has bought more clarification.**

This clause shall not apply to Qualified Institutional Buyers (QIBs) and shares issued to employees of the Company under scheme of ESOP. This provision is not applicable to Non-Banking Financial Companies (NBFCs) registered with Reserve Bank of India (RBI) and Housing Finance Companies (HFCs) that comply with regulations formulated by Reserve Bank of India for private placements.

Approval from Shareholders: The private placement should be approved by shareholders by way of special resolution for each of the offer along with explanatory statement annexed to it and the approval shall be valid for particular financial year. **Under the Act, 1956, ordinary resolution was required to approve private placements and that too only for public limited companies. The board had sole discretion to make private placements for private limited companies. This lacuna has been plugged by the Act, 2013 and is a progressive step towards shareholders participation. However, minority shareholders still may have limited say in resolution which may affect their interest which needs to be addressed.**

Form and manner

[Section 42(3)]: Private placement offer–cum–application letter (PAS-4) should be serially numbered and sent to identified persons in writing or electronic mode within 30 days of recording the name of such person. The new law also expressly restricts the right of renunciation, earlier no such restriction was imposed.

Company has to maintain complete record of private placement offers in Form PAS-5

For public companies (listed as well as unlisted) it is now mandatory to issue fresh securities in dematerialised form only.

Funds mobilised

[Section 42(4)]: The subscribers (identified persons who are willing to apply) shall have to apply through the offer letter and shall have to pay the subscription amount through cheques, demand drafts or any other banking channels (NEFT/RTGS) only. Collecting subscription money by way of cash is not permitted.

Company should ensure that payment made for subscription should come from bank account of person subscribing to the security and has to keep a record of the bank account from where the money has been received. **Hence, a clear nexus can now be made through banking transactions as to when and from where the funds were received. Mandatory payment through banking channels shall do away with transactions that were earlier recorded as mere book entries.**

New provision requires the company to first file Return of Allotment (PAS-3) to be filed within 15 days from the date of allotment (instead of erstwhile 30 days) in order to utilise the funds. The company shall be unable to use the funds unless PAS-3 is filed with Registrar of Companies. **This is to curb the practice of companies that accepted funds as subscription money and utilised the funds without completing the allotment process. On receipt of funds, companies gave a deaf ear to compliances and had a laid back approach for statutory filings. This stringent provision shall bring in more disciplined and improved governance for timely compliance.**

The requirement of minimum of offer/ invitation per person of ₹ 20,000/- of face value has been done away with.

Fresh Offer

[Section 42(5)]: Company cannot make any fresh offer under this section unless all the pending allotments have been completed /withdrawn/ abandoned.

Allotment

[Section 42(6)]: Company has to allot the securities within sixty days from the date of receipt of money, otherwise the money has to be refunded to the subscriber within fifteen days after expiry of sixty days (60+15 days). On failure to refund the money, company shall be liable to pay interest at the rate of twelve per cent per annum (12% p.a.) after expiry of fifteen days. **This provision along with restriction on utilisation of funds before allotment is welcome step which will help to curb law abuse where companies did not follow strict refund timelines and made interim use of funds.**

Moreover, if the securities are not allotted and amount is not refunded to the subscribers within fifteen days, such amount shall be treated as a deposit as per Companies (Acceptance of Deposit) Rules, 2014.

The funds received through subscription has to be kept in separate bank account and shall not be used for purpose other than allotment / refund. **A clear and concise demarcation has to be made between the subscription funds and other funds received from the same party. Many a times, receivables, loans and advances and receipts of like nature from parties were shown as subscription money to account for sham allotments. Since the volume between the parties were huge, no clear identification could be made. This provision shall further aid in elimination of manipulations by companies.**

Publicity

[Section 42(7)]: This section prohibits company to release any public advertisements/ media publication, using marketing or distribution channels / agents to publicise about the offer. **As this is private placement, no act of solicitation should be made to public at large.**

ROC filings

[Section 42(8)] As stated earlier Return of Allotment (Form PAS 3) has to be filed within fifteen days from the date of allotment. The form shall mandatory include

i. list of all allottees their full names, address, PAN, email ID

ii. class of security & date of allotment

iii. nominal value, consideration received or whether consideration was other than cash

iv. number of securities allotted and offer price
v. amount of funds raised
vi. justification for offer price
vii. valuation report and details of valuer
viii. board resolution

Clearly it is evident that law makers have left no stone unturned to protect the interest of stakeholders and pushed the companies to provide true and fair information to the regulatory authorities and various stakeholders of the company.

Penalty for non-filing

[Section 42(9)] If Company defaults in filing Return of Allotment, PAS-3, (i.e. after 15 days) – Company, Promoters and Directors shall be liable for penalty of Rupees One Thousand per day subject to maximum of Rupees Twenty Five lakhs.

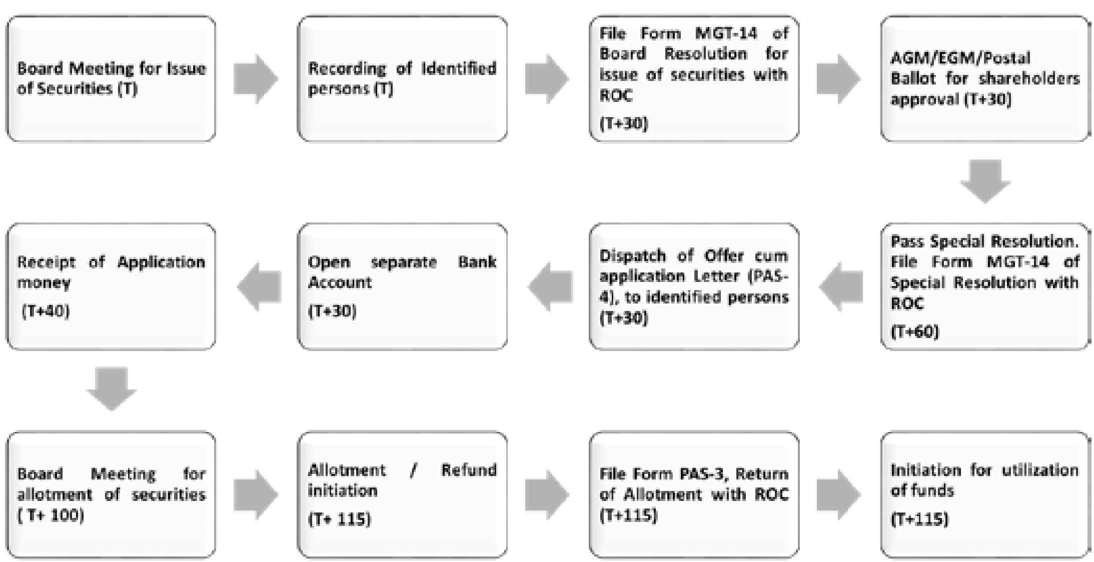
Penalty for contraventions

[Section 42(10)]: If Company contravene any provision of Section 42 – Company, Promoters and Directors shall be liable to penalty of amount raised subject to maximum of Rupees Two crore (instead of earlier provision wherein the minimum penalty was Rupees Two crore). **Such high penalties shall ensure that the law abusers are at their toes with compliances and the dignity of law is maintained, the law is followed in true spirit and adhered with at all times.**

Deemed public offer

[Section 42(11)]: Over and above the clauses 9 and 10 above, any non-compliance of section 42 shall deem to be a public offer and all other relevant provisions of Companies Act, Securities Contracts (Regulation) Act and Securities and Exchange Board of India Act, 1992 shall be applicable to the Company.

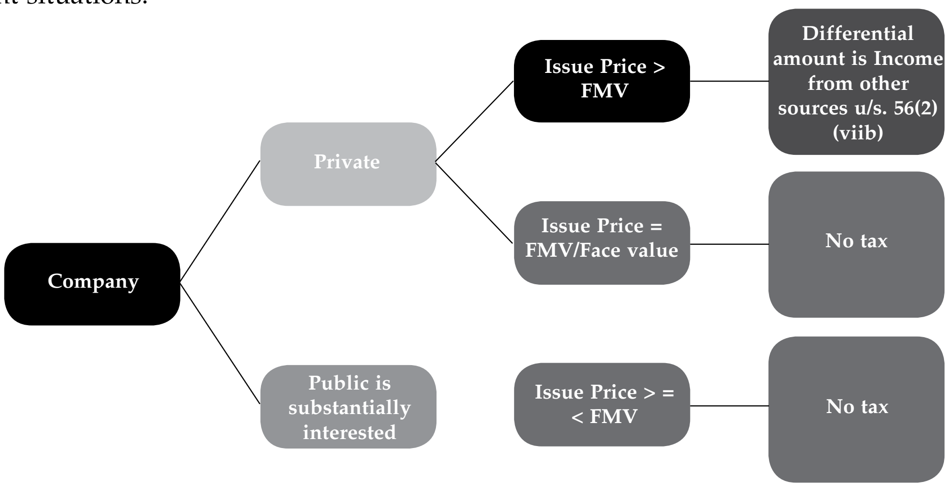
Indicative timeline for private placement under Companies Act



*The timeline illustrated above are with upper limits, a shorter timeline can also be achieved, provided company completes the process in the shorter time. A clear notice of 21 days have to be mandatorily given to shareholders for AGM/EGM. In case of postal ballot, voting has to be kept open for a period of 30 days.

Private Placement under Income-tax Act

Price at which a shares are issued and it Fair Market Value (FMV) are the most important factors that determine taxability under the Income-tax Act. The below mentioned chart illustrates the taxability in different situations.



Rule 11UA of Income Tax Rules enumerates the methodologies for computation of FMV.

Issue of securities to non-resident shareholders

Where there is issue of securities to non-resident, provisions of Foreign Exchange Management (Transfer or Issue of Security by a Person Resident Outside India) Regulations, 2017 (FEMA), shall also apply. The company will have to adhere the following timeline:

- within 60 days of receipt of money, company is required to allot the shares
- within 30 days of allotment, company is required to file FC-GPR under Single Master Form (SMF), with RBI. Under the revised procedure of intimation of FDI, the two staged reporting (first at the time or receipt of share application money and second at the time of allotment) has been merged into one step reporting under SMF.

FMV under FEMA is calculated as per internationally accepted pricing methodologies and is considered the floor price.

Way forward

These reforms are indeed a helping aid to improve India's productivity besides boosting the country's investment environment through simplified and clear laws being implemented uniformly. A move from ''License Raj'' to the spirit of "Ease of doing business", the major changes introduced by the Companies (Amendment) Act, 2017 are aimed at:

- Addressing difficulties in implementation owing to stringent compliance requirements;
- Facilitating ease of doing business in order to promote growth with employment;
- Harmonisation with accounting standards, the Securities and Exchange Board of India Act, 1992 and the regulations made thereunder, and the Reserve Bank of India Act, 1934 and the regulations made thereunder;
- Rectifying omissions and inconsistencies/ ambiguities in the Act;
- Simplifying compliance requirements for the Companies;
- Provide for stringent penalties to punish the defaulting Companies.

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Dr. K. R. Chandratre, *Company Secretary*

An Interpretational Study of the New Section 185 of the Companies Act 2013

Sub-sections (1), (2) and (3) of section 185 of the Companies Act 2013, as substituted by the Companies (Amendment) Act 2017, reads as follows:

“185. [2]Loans to directors, etc.[3]

(1) No company shall, directly or indirectly, advance any loan, including any loan represented by a book debt to, or give any guarantee or provide any security in connection with any loan taken by, —

1. Substituted by Companies (Amendment) Act, 2017, ***w.e.f. 7-5-2018***, *vide* Notification F. No. 1/1/2018-CL.I, dated 7-5-2018 for the following:

   “[1]***185. Loan to directors, etc.***.— (1) Save as otherwise provided in this Act, no company shall, directly or indirectly, advance any loan, including any loan represented by a book debt, to any of its directors or to any other person in whom the director is interested or give any guarantee or provide any security in connection with any loan taken by him or such other person:

   Provided that nothing contained in this sub-section shall apply to—

   (a) the giving of any loan to a managing or whole-time director—

   (i) as a part of the conditions of service extended by the company to all its employees; or

   (ii) pursuant to any scheme approved by the members by a special resolution; or

   (b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the bank rate declared by the Reserve Bank of India;

   [2][(c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or

   (d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company:

   Provided that the loans made under clauses (c) and (d) are utilised by the subsidiary company for its principal business activities.]

   Explanation.—For the purposes of this section, the expression "to any other person in whom director is interested" means—

(a) any director of company, or of a company which is its holding company or any partner or relative of any such director; or

(b) any firm in which any such director or relative is a partner.

(2) A company may advance any loan including any loan represented by a book debt, or give any guarantee or provide any security in connection with any loan taken by any person in whom any of the director of the company is interested, subject to the condition that—

(a) a special resolution is passed by the company in general meeting:

Provided that the explanatory statement to the notice for the relevant general meeting shall disclose the full particulars of the loans given, or guarantee given or security provided and the purpose for which the loan or guarantee or security is proposed to be utilised by the recipient of the loan or guarantee or security and any other relevant fact; and

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(a) any director of the lending company, or of a company which is its holding company or any partner or relative of any such director;
(b) any firm in which any such director or relative is a partner;
(c) any private company of which any such director is a director or member;
(d) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or
(e) any body corporate, the Board of directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company. <= <=

<= <= (2) If any loan is advanced or a guarantee or security is given or provided in contravention of the provisions of sub-section (1), the company shall be punishable with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, and the director or the other person to whom any loan is advanced or guarantee or security is given or provided in connection with any loan taken by him or the other person, shall be punishable with imprisonment which may extend to six months or with fine which shall not be less than five lakh rupees but which may extend to twenty-five lakh rupees, or with both."

1 ***W.e.f. 12-9-2013*** *vide* Notification No. SO 2754(E), dated 12-9-2013.

2 Inserted by Companies (Amendment) Act, 2015, ***w.e.f. 29-5-2015.***

2 **See** Rule 10, Companies (Meetings of Board and its Powers) Rules, 2014. **See** General Circular No. 3/2014, dated 14-2-2014 and General Circular No. 4/2015, dated 10-3-2015.

3 **Exceptions, Modifications and Adaptations for Government Company under section 462.—** Shall not apply to Government company in case such company obtains approval of the Ministry or Department of the Central Government which is administratively in charge of the company, or, as the case may be, the State Government before making any loan or giving any guarantee or providing any security under the section. *[Notification No. GSR 463(E), dated 5-6-2015]*

Exceptions, Modifications and Adaptations for Private Company under section 462.— Shall not apply to a private company—
(a) in whose share capital no other body corporate has invested any money;
(b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and
(c) such a company has no default in repayment of such borrowings subsisting at the time of making transactions under this section *[Notification No. GSR 464(E), dated 5-6-2015]*

Exceptions, Modifications and Adaptations for Nidhis under section 462.—Shall not apply, provided the loan is given to a director or his relative in their capacity as members and such transaction is disclosed in the annual accounts by a note. *[Notification No. GSR 465(E), dated 5-6-2015]*

Exceptions, Modifications and Adaptations to an unlisted public company licensed to operate from IFSC located in approved SEZ under section 462.—In the *Explanation*, for clause (c), the following clause shall be substituted, namely:—

"(c) any private company of which any such director is a director or member in which director of the lending company do not have direct or indirect shareholding through themselves or through their relatives and a special resolution is passed to this effect;" *[Notification No. GSR 8(E), dated 4-1-2017]*

(b) the loans are utilised by the borrowing company for its principal business activities.

Explanation.— For the purposes of this sub-section, the expression "any person in whom any of the director of the company is interested" means—

(a) any private company of which any such director is a director or member;

(b) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together; or

(c) any body corporate, the Board of Directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

(3) Nothing contained in sub-sections (1) and (2) shall apply to—

(a) the giving of any loan to a managing or whole-time director—

  (i) as a part of the conditions of service extended by the company to all its employees; or

  (ii) pursuant to any scheme approved by the members by a special resolution; or

(b) a company which in the ordinary course of its business provides loans or gives guarantees or securities for the due repayment of any loan and in respect of such loans an interest is charged at a rate not less than the rate of prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan; or

(c) any loan made by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company; or

(d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company:

Provided that the loans made under clauses (c) and (d) are utilised by the subsidiary company for its principal business activities."

Prohibited loans, guarantees and securities

Sub-section (1) of the new section 185 prohibits giving loans by any company (public or private), directly or indirectly, including any loan represented by a book debt, to, and providing guarantees or securities in connection with any loan, on behalf of-

- any director of the company,
- any director of the company which is its holding company,
- any partner of any director of the company,
- any relative of any director of the company,
- any firm in which any director of the company is a partner,
- any firm in which any relative of any director of the company is a partner.

Exceptions, Modifications and Adaptations to a private company licensed to operate from IFSC located in approved SEZ under section 462.—In the Explanation, for clause (c), the following clause shall be substituted, namely:—

"(c) any private company of which any such director is a director or member in which director of the lending company do not have direct or indirect shareholding through themselves or through their relatives and a special resolution is passed to this effect.". [Notification No. GSR 9(E), dated 4-1-2017]

No loan can be given to, and no guarantee/ security in connection with a loan can be provided on behalf of, any of the abovementioned parties by any company, even with the approval of the board or shareholders or the Central Government.

Loans, guarantees, securities permitted with members' approval

Under sub-section (2), giving loans by any company (public or private), directly or indirectly, including any loan represented by a book debt, to, and providing guarantees or securities in connection with any loan, on behalf of, any of the following parties is permitted subject to compliance with certain conditions:

- any private company of which any director of the company is a director,
- any private company of which any director of the company is a member;
- any body corporate if at its general meeting 25% or more of the total voting power is exercised or controlled by any one more directors of the company,
- any body corporate, if its Board of directors, managing director or manager is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

The conditions which must be fulfilled for giving a loan or providing a guarantee or security, are as follows:

First, it must be approved by the members of the company by a special resolution in general meeting.[4]

Second, the amount of the loan given must be utilised by the borrowing company for its principal business activities.

As regards the first of the two conditions, the explanatory statement to the notice of the relevant general meeting must disclose full particulars of the loan to be given, or guarantee/ security to be provided and the purpose for which the loan/guarantee/security is proposed to be utilised by its recipient and any other relevant fact.

Exempted loans, guarantees and securities

Sub-section (3) of the new section 185 fully exempts loans/guarantees/securities in the following cases:

(a) a loan to a managing or whole-time director— (i) as a part of the conditions of service extended by the company to all its employees; or (ii) pursuant to any scheme approved by the members by a special resolution;

(b) loans/guarantees/securities by a company the ordinary course of its business;[5]

(c) a loan by a holding company to its wholly owned subsidiary company or any guarantee given or security provided by a holding company in respect of any loan made to its wholly owned subsidiary company;

(d) any guarantee given or security provided by a holding company in respect of loan made by any bank or financial institution to its subsidiary company.

Any loan falling under clauses (c) and (d) must be utilised by the subsidiary company for its principal business activities.

Penal consequences of contravention

As per sub-section (4), if any loan is given or a guarantee/security is provided or a loan utilised in contravention of the provisions of this section, the company shall be punishable with fine of

4 This approval may be taken by passing a special resolution by postal ballot.

5 On the loan, an interest must be charged at a rate not less than the rate of prevailing yield of one year, three year, five year or ten year Government security closest to the tenor of the loan.

a minimum of ₹ 5 lakhs and a maximum of ₹ 25 lakh.

Every officer of the company who is in default shall be punishable with imprisonment up to six months or with fine of a minimum of ₹ 5 lakh and a maximum of ₹ 25 lakh.

In addition, the director or the other person to whom any loan is given or guarantee/ security provided, shall be punishable with imprisonment up to six months or with fine of a minimum of ₹ 5 lakh and a maximum of ₹ 25 lakh, or with both.

Guarantees/securities must be in connection with loan

To attract this section, a guarantee given or security provided by a company must be in connection with any loan taken by a director or any other person in whom the director is interested. The phrase 'in connection with' means relating to; in relation to; about; concerning; regarding; as regards; with respect; with regard to; in respect of. Thus, in order for the transaction of a guarantee to fall under this section, there must be a loan taken by any person or body corporate and a company must provide its guarantee in favour of the lender and on behalf of the borrower. Then only it will be a guarantee in connection with a loan. This section would not apply unless the basic transaction between the two parties to the basic transaction is lending and borrowing of money.

Any guarantee or security which does not involve the transaction of lending and borrowing of money between a body corporate and a third party (whether a body corporate or not) would not attract the provisions of this section. For example the following types of guarantees will not attract the provisions of this section:

(a) performance guarantees given to third parties on behalf of other companies;

(b) guarantees against advance received in respect of a contract for supply of goods or a project;

(c) bank guarantees given in connection with business transactions which do not involve lending of money but some other obligation.

In the case of a 'performance guarantee' to be given in respect of a contract for supply of equipment or erection of plant or execution of a project, there are four parties involved: (1) a bank; (2) a company which has undertaken execution of a contract in respect of certain assurances have been given by it regarding performance of the contract; (3) the customer in whose favour a performance guarantee is to be given; and (4) another company whose back-up guarantee is to be given to the bank. But the contract of guarantee issued by a company in favour of a bank has three parties. If the contractor fails to give assured performance of the equipment or project, the customer encashes the guarantee given by the bank and the bank asks the back-up guarantor to pay what the bank has paid to the customer. This transaction does not involve a loan and hence the guarantee given by the back-up guarantor is not in connection with a loan.

Interpretation of clause (b) of sub-section (2)

Clause (b) of subsection (2) reads as follows:

"(b) any body corporate at a general meeting of which not less than twenty-five per cent of the total voting power may be exercised or controlled by any such director, or by two or more such directors, together."

This means, unless one or more director(s) of the lending company holds/hold or controls/control 25% or more voting power in the borrowing company, this clause will not be attracted. The voting power in the borrowing company must be held or controlled by a director (or two or more directors) of the lending company.

While the word 'exercises' indicates that the voting power in respect of the shares carrying voting rights must be exercised by the director(s), the word 'controls' indicates that the shares may be held by someone but the voting power is vested in the director(s) either under some agreement or under some other document which empowers the director(s) to control the voting power. Without any such document, it cannot be presumed that the director(s) has the power to control the voting power. In either case, only the voting power exercised or controlled by the director(s) of the lending company must be considered; voting power of other persons or companies cannot be considered.

The voting power held by any other person or company or a relative of a director is not to be considered for the purpose of clause (d) because that will amount to rewriting of the statute and as noted above such rewriting of a statutory provision is not permissible. Voting power can be said to be controlled only if the director controlling it is the beneficial owner of the shares but the shares are held by someone else.

Therefore, in my opinion, going by the plain language of the provision in clause (d), unless 25% more of the total voting power of the borrowing company is held by a director himself, in his own name(s), clause (d) will not be attracted, unless it is controlled by a director in respect of the shares by someone else in which case there must be a documentary evidence giving such control to the director. It cannot be presumed voting power in respect of any shares held by that a relative of or any other party connected with a director holding is controlled by the director. There is no provision in clause (d) suggesting such presumption.

Interpretation of clause (c) of sub-section (2)

Clause (c) of sub-section (2) reads as follows:

"(c) any body corporate, the Board of Directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company."

This clause applies when a loan is to be given to, or a guarantee or security in compliance with a loan is to be provided on behalf of, any body corporate and the board of directors, managing director or manager, of that body corporate is accustomed to act in accordance with the directions or instructions of the board, or of any director or directors, of the company. Thus in order that this clause applies, the following conditions must be fulfilled:

(a) A company lends money to, or provides a guarantee or security on behalf of, a body corporate (incorporated under the Companies Act as a company or incorporated under some other Act);

(b) The board or any director or directors, of the company lending money or providing a guarantee or security issues/issue directions or instructions to that body corporate or its board, managing director or manager;

(c) Such body corporate or its board, managing director or manager is accustomed to act in accordance with those directions or instructions.

The board, or any director or directors, of the company, according to whose directions or instructions the Board of Directors, managing director or manager, of that body corporate is accustomed to act, is called a 'deemed director', meaning a person who has not been appointed as a director but who acts and exercises powers like a director by remaining behind the screen. In England such a person is called a 'shadow director'. If someone has not been formally appointed as a director but is a person 'in accordance with whose instructions or directions the directors of a company are accustomed to act' then that person is a 'shadow director'. The influence of the shadow director over the board must be real but need not extend over the whole of the company's activities.

This provision was inserted in section 295 of the 1956 on the recommendation of the Company

Law Committee (1952) to make the section applicable where "A director of the lending company may not ostensibly be associated with the management of the borrowing company but he may be the moving spirit behind it."

A person who is not a director of a company but who gives instructions (rather than professional advice) according to which the directors are accustomed to act, is called a shadow director. A shadow director is a legal person who controls the company but is not officially appointed as a director (an officially appointed director is a *de jure* director); a *de facto* director is also not officially appointed but effectively sits on the board and is involved with decision-making.

This concept was absent in Indian Companies Act, 1913. The Companies Act, 1956 introduced this concept.[6] It was embodied in the definition of 'officer' as being any person in accordance with whose directions or instructions the Board of Directors is accustomed to act, but excluded from the definition the persons who give such directions or instructions in their professional capacities.[7] As a matter of fact, these persons are sought to be roped not in the category of 'director', but in the category of 'officer'.

The Companies Act uses but does not give a definition of the expression 'person in accordance with whose directions or instructions directors are accustomed to act'. Clause (v) of the definition of 'officer who is in default' in section 2(60) excludes advice given by person in a professional capacity, but clause (e) of the *Explanation* in section 185 does not exclude it. Section 7 of the 1956 Act provided that "Except where this Act expressly provides otherwise, a person shall not be deemed to be, within the meaning of any provision in this Act, a person in accordance with whose directions or instructions the Board of directors of a company is accustomed to act, by reason only that the Board acts on advice given by him in a professional capacity." The definition given in the UK Companies Act (noted below) also provided for this exception. No such exception has been provided for in section 185, with the result that a question is going to arise whether a professional advice would attract clause (e) of the *Explanation* to section 185. In the definition of 'related party' in section 2(76), however, this exception has been provided for in clause (vii).

Some statutory provisions apply to both shadow directors and directors proper. Some provisions of Companies Act also apply to 'shadow directors', as they are described in Companies Act, being persons in accordance with whose directions or instructions the board of directors of the company is accustomed to act. But, except where Companies Act expressly provides otherwise, the expression "a person in accordance with whose directions or instructions the board is accustomed to act", does not include a person who gives advice to the board in a professional capacity. These persons are not 'appointed' as directors; they are deemed to be the directors.

In section 2(76) defining 'related party' it is used as "any body corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager." In the same provision it is used as "any person on whose advice, directions or instructions a director or manager is accustomed to act."

The definition of 'officer' also embody this concept; according to which any person in accordance with whose directions or instructions the Board of Directors or any one or more of the directors is or are accustomed to act is an officer.

In section 2(69), it is used in the definition of 'promoter' to include a person in accordance with whose advice, directions or instructions the

6. Companies Act, section 2(30).

7. Companies Act, section 7; English Companies Act, 1948, section 455(2).

Board of Directors of the company is accustomed to act.

In section 185, it is used as, any body corporate, the Board of Directors, managing director or manager, whereof is accustomed to act in accordance with the directions or instructions of the Board, or of any director or directors, of the lending company.

In section 219 it is used as any other body corporate whose Board of Directors comprises nominees of the company or is accustomed to act in accordance with the directions or instructions of the company or any of its directors.

In sections 336 and 339 the definition of 'officer' includes any person in accordance with whose directions or instructions the directors of the company have been accustomed to act.

In section 386 the expression 'director', in relation to a foreign company, includes any person in accordance with whose directions or instructions the Board of Directors of the company is accustomed to act.

Section 538 of the Companies Act, 1956 made liable past and present officers of a company which was being wound-up and sub-section (3) of that section provided that "For the purposes of this section, the expression "officer" shall include any person in accordance with whose directions or instructions the directors of the company have been accustomed to act." The definition of 'officer' in section 2(30) of the Act also provided that officer included any person in accordance with whose directions or instructions the Board of directors or any one or more of the director is or are accustomed to act. In Official Liquidator, *Golcha Properties P. Ltd. (In Liquidation) vs. Dhadda (P.C.)*[8] the question before the court was whether the secretary, chief accountant and cashier of the company which was in winding-up were 'officers' of the company or not. Answering that question in the affirmative, the court held that,—

"The present definition of the word "officer" is wide enough and would include anybody on whose instructions the board or any of the directors of the company is accustomed to act. This is designed to counter the threat whereby dummy directors are appointed on boards of companies to implement policies of a dubious nature, while masterminds mainly instrumental in evolving those policies remain in the background. According to Stroud's Judicial Dictionary "office" means a person under a contract of service; a servant of special status holding an appointment to an office which carries with it an authority to give directions to other servants. Shri P. C. Dhadda was the secretary, Shri G. L. Jain, accountant, and Shri K. C. Jain, cashier, in the relevant year 1965, in *M/s. Golcha Properties (P.) Ltd.* The voucher No. 320, dated 25th August, 1965, was prepared by these persons. Shri P. C. Dhadda signed it as secretary, Shri G. L. Jain signed it as chief accountant and Shri K. C. Jain prepared the same as cashier. From the above discussion, it is apparent that during the relevant period, non-petitioners Nos. 2 and 3 were the officers of the said company as defined in sub-section (30) of section 2 of the Indian Companies Act."

Section 2(g)(viii) of the Monopolies and Restrictive Trade Practices Act, 1969 defined the expression "inter-connected undertaking" and according to clause (ix) of the Explanation appended to that definition, two bodies corporate, shall be deemed to be under the same management if the directors of the one such body corporate are accustomed to act in accordance with the directions or instructions of one or more of the directors of the other, or if the directors of both the bodies corporate are accustomed to act in accordance with the directions or instructions of an individual, whether belonging to a group or not.

In the Monopolies and Restrictive Trade Practices Act 1969 provided, in the definition of 'inter-connected undertakings' in section 2(1)

8. (1980) 50 Comp Cas 175 (Raj).

(g), that two bodies corporate, shall be deemed to be under the same management, *inter alia*, if the directors of the one such body corporate are accustomed to act in accordance with the directions or instructions of one or more of the directors of the other, or if the directors of both the bodies corporate are accustomed to act in accordance with the directions or instructions of an individual, whether belonging to a group or not. In *Swastik Textile Mills Ltd In re [1985] 57 Comp Cas 766 (Bom)*, one of two directors (H) of company A was officiating as chief executive of company L. It was contended that because H was a chief executive of L, it must be presumed that in his capacity as a director of A, he would act in accordance with the directions given to him by the directors of the L. However, the court disagreed with contention and held that whether certain persons are accustomed to act in a particular manner or not is something which can be shown by instances of past behaviour or other material facts and not by mere presumptions. Not a single instance has been given of H having acted in his capacity as a director of A pursuant to the directions given to him by the directors of L; hence, it cannot be said that he was accustomed to act in accordance with such directions given by the directors of L.

Section 545 of the Companies Act, 1956 empowers the court to direct the liquidator either himself to prosecute any past or present officer, or any member, of the company has been guilty of any offence in relation to the company, if it appears to the Court in the course of a winding up that he has been guilty of any offence in relation to the company. In *Official Liquidator vs. Sudarshan (T.)*[9], two persons (eighth and ninth respondents) were group vice president and chairman but not directors of the company and they were also promoters of the company. It was found that they were *de facto* in charge of the affairs of the company. They had not placed themselves as directors in order to avoid any statutory liability. The person who was the group president and issued directions to the board of directors of a company who were employees of the company and the so-called group president in a letter had accepted the fact that they were responsible for all the affairs of the company and they were the persons in accordance with whose directions or instructions, the board is accustomed to act, it was held that the group president was liable for prosecution under section 545 of the Companies Act (any past or present officer of the company in liquidation has been guilty of any offence in relation to the company, as an officer of the company.

Section 741 of the UK Companies Act, 1985 defined 'shadow director' as a person in accordance with whose directions or instructions the directors of the company are accustomed to act. However a person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity.

Section 251 of the UK Companies Act, 2006 gives the same definition. It reads as follows:

"251 Shadow director.— (1) In the Companies Act "shadow director", in relation to a company, means a person in accordance with whose directions or instructions the directors of the company are accustomed to act.

(2) A person is not to be regarded as a shadow director by reason only that the directors act on advice given by him in a professional capacity."

Under section 214 of the Insolvency Act, 1986 of the UK, the liability for wrongful trading imposed by the section applied to *de facto* directors as well as to *de jure* and shadow directors.

Section 22(5) of the Directors Disqualification Act, 1986 (UK) defines the expression 'shadow director' as:

'... a person in accordance with whose directions or instructions the directors of the company are

9. (2003) 116 Comp Cas 88 (Mad).

accustomed to act (but so that a person is not deemed a shadow director by reason only that the directors act on advice given by him in a professional capacity).'

This concept has undergone considerable judicial discussion in the UK and the most debatable point has been as to the interpretation of the expressions 'directions or instructions' and 'accustomed to act'. In particular, what amounts to directions or instructions and whether a single act of giving direction or instruction would suffice or whether the expression 'accustomed to act' contemplates continuous acts of giving directions or instructions, are the crucial questions.

In *Hydrodan (Corby) Ltd, In re,*[10] the Chancery Court of UK held that to establish that a person is a shadow director of a company it is necessary to allege and prove: (1) who are the directors of the company, whether *de facto* or *de jure*; (2) that the defendant directed those directors how to act in relation to the company or that he was one of the persons who did so; (3) that those directors acted in accordance with such directions; and (4) that they were accustomed so to act. What is needed is, first, a board of directors claiming and purporting to act as such; and, secondly, a pattern of behaviour in which the board did not exercise any discretion or judgment of its own, but acted in accordance with the directions of others."

In *Secretary of State for Trade and Industry vs. Deverell*[11], it has been held that, for the purposes of section 22(5) of the Directors Disqualification Act, 1986, the question whether a particular communication constituted a direction or instruction had to be answered in the light of all the evidence, and it was not necessary to prove the understanding or expectation of either giver or receiver. Evidence of such an understanding or expectation might be relevant, but it could not be conclusive. Furthermore, non-professional advice could fall within section 22(5). Such a conclusion appeared to be assumed by the proviso excepting advice given in a professional capacity, and in any event the concepts of 'direction' and 'instruction' did not exclude the concept of 'advice' since all three shared the common features of 'guidance'. Moreover, although it would be sufficient to show that properly appointed directors had cast themselves in a subservient role or surrendered their discretions in the face of 'directions or instructions' from the alleged shadow director, it would not always be necessary to do so. Such instructions or directions did not have to extend over all or most of the corporate activities of the company, and it was not necessary to demonstrate a degree of compulsion in excess of that implicit in the fact that the board was accustomed to act in 365 accordance with them. Moreover, it was not necessary for the shadow director to lurk in the shadows, although he might frequently do so.

In *Re Kaytech International plc*[12], the Court of Appeal of UK expressed a view that the instructions or directions do not have to cover the whole of the company's activities but must cover at least those matters essential to the corporate governance of a company including control of its financial affairs and the label attached to the communications from the shadow to the board are immaterial provided that the communication is understood or expected by both giver and receiver to be followed by the latter.

Accustomed means customary; usual; habitual; being in the habit or custom; habituated; regular; acclimated. The phrase 'accustomed to' means be used to. According to The Webster's Third New International Dictionary, accustomed means familiar through use or long and repeated experience; often used or practiced; customary; habitual; usual; in the habit or custom; established in the practice.

10. (1994) BCC 161. **See also** Secretary of State for Trade and Industry v Laing (1996) 2 BCLC 324.
11. (2000) 2 All ER 365.
12. (1999) 2 BCLC 351.

Where service rules provided for disciplinary action against the persons habitually absent, the Supreme Court held that a single instance of absence was not sufficient to fall within the teeth of requirement of habitual absence; the absence for one day and in another year for one night cannot be considered to be regular absence.[13]

With regard to section 60 of the Corporations Law (Australia) in *Australian Securities Commission vs. AS Nominees Ltd*.[14] Finn J, sitting in the Federal Court of Australia, was concerned with petitions to wind up various trust companies of which Windsor was a manager. Finn J. held (at 52) that:

'The reference in the section to a person in accordance with whose directions or instructions the directors are "accustomed to act" does not in my opinion require that there be directions or instructions embracing all matters involving the board. Rather it only requires that, as and when the directors are directed or instructed, they are accustomed to act as the section requires.'

In one English case, the meaning of the definition of 'shadow director' in section 741 of the UK Companies Act, 1985 was explained as follows:

'…those words can only mean … that the shadow director must be, in effect, the puppet master controlling the actions of the board. The directors must be (to use a different phrase) the 'cat's paw' of the shadow director. They must be people who act on the directions or instructions of the shadow director as a matter of regular practice. That last requirement follows from the reference in the sub-section to the directors being 'accustomed to act'. That must refer to acts not on one individual occasion but over a period of time and as a regular course of conduct. …there can be no way in which the acts of any one of several directors of a company in complying with the directions of an outsider could constitute that outsider a shadow director of that company. Of course, if the board of the company be one person only and that person is a 'cat's paw' for an outsider, the outsider may be the shadow director of that company. But in a case such as this, with a multi-member board, unless the whole of the board, or at the very least a governing majority of it,… are accustomed to act on the directions of an outsider, such an outsider cannot be a shadow director, further, there must be, as I say, more than one act and a course of conduct.'[15]

In *Secretary of State for Trade and Industry vs. Deverell*[16] and followed in *Re Mea Corporation Ltd*[17] it was held: Whether any particular communication from the alleged shadow director, whether by words or conduct, is to be classified as a direction or instruction must be objectively ascertained by the court in the light of all the evidence. In that connection it is not necessary to prove the understanding or expectation of either giver or receiver. In many, if not most, cases it will suffice to prove the communication and its consequence. Evidence of such understanding or expectation may be relevant but it cannot be conclusive. Certainly the label attached by either or both parties then or thereafter cannot be more than a factor in considering whether the communication came within the statutory description of direction or instruction. It will, no doubt, be sufficient to show that in the face of "directions or instructions" from the alleged shadow director the properly appointed directors or some of them cast themselves in a subservient role or surrendered their respective discretions. But it is not necessary to do so in all cases. Such a requirement would be to put a gloss on the statutory requirement that the board are

13. Malkiat Singh vs. State of Punjab (1996) 7 SCC 634.
14. (1995) 133 ALR 1.
15. Re Unisoft Group Ltd (No. 3) (1994) 1 BCC 609: 1994 BCC 766.
16. (2000) 2 BCLC 133
17. (2007) 1 BCLC 618: (2007) BCC 288

"accustomed to act" "in accordance with" such directions or instructions.

A person who played active part in the management of the company at any stage and there was no evidence that he gave any instructions on which the directors of the company accustomed to act, was held to be not a shadow director.[18]

In *Kilnoor Ltd In re [2006] 2 WLR 974*, with reference a single event of approval of issuing a debenture it was argued that the directors of the company were accustomed to act on the directions of another company. However, rejecting the argument said: "I do not see how the completion of a single transaction on a single day (which was itself the very day on which the board were appointed) can amount to being "accustomed" to act. Inherent in the notion of being accustomed to act on someone's instruction is conduct over a period of time. In so far as the allegation is directed at the old board, there is no evidence that they acted on anyone's instructions or at anyone's direction."

Thus, to hold that the board is accustomed to act in accordance with directions or instructions of a person, it has to be established that there have been a series of events in which the board may have acted in accordance with such instructions and a single isolated event or two would not be sufficient. The Board of one company cannot be presumed to be acting in accordance with the directions or instructions of the Board of another company, unless there is evidence to the effect that—

- Firstly, the second company has been issuing directions or instructions to the Board of the first company in connection with conduct of affairs and management of the first company and also its policies and business practices, etc.; and
- Secondly, the Board of the first company has been following and acting according to such directions or instructions.

In one English case, section 249(10) of the Insolvency Act, 1986 provided that a person is to be taken as having control of a company if, *inter alia*, the directors of the company or of another company which has control of it (or any of them) are accustomed to act in accordance with his directions or instructions. The court pointed out that inherent in the notion of being accustomed to act on someone's instruction is conduct over a period of time. When it is alleged that the board of a company is accustomed to act on the instructions of somebody, there must be evidence that the board is accustomed to act on anyone's instructions or at anyone's direction. The mere fact that the board shared directors with other companies (of which a company is a parent company) does not lead to the conclusion that the directors failed to exercise their powers as directors of the company in good faith, in the company's interests and as the result of independent decisions made by them.[19]

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18. Secretary of State for Trade and Industry vs. Hall 2009 BCC 191 (Ch D).
19. Kilnoore Ltd, In re (2005) 3 All ER 730 (Ch).

Nobody will come to help you if you put yourelf forward as a leader ....
Kill self first if you want to succeed.

— *Swami Vivekananda*

Makrand Joshi, *Company Secretary*

Whether LLP can merge in Company?

Introduction

Whether LLP can merge in Company by following the process under section 230-232 of the Companies Act 2013 is a question which was so far being answered negatively or was unanswered. However, NCLT Chennai in the case of merger of Real Image LLP (transferor entity) with Qube Cinema Technologies Private Limited (transferee entity)[1] allowed the scheme of arrangement. Hence it becomes interesting to understand the question of law and interpretation done by Chennai NCLT.

Provisions under Companies Act 1956 [hereinafter referred to as 1956 Act]

Provisions pertaining compromise or arrangement are dealt with in section from 391 to 396. Although scheme of compromise of arrangement was broadly discussed in section 391 to 393, Merger or Amalgamation was specifically dealt with under section 394 of the 1956 Act. Further sub section (4) of section 394 of the 1956 Act states that,

In this section, "transferee company" does not include any company other than a company within the meaning of this Act; but" transferor company" includes any body corporate, whether a company within the meaning of this Act or not.

As a result of this it was considered that, although Transferor Company includes body corporate (even if that entity is not a company registered under 1956 Act or any earlier act) Transferee Company has to be a company within the meaning of 1956 Act.

Provisions under Companies Act 2013 [hereinafter referred to as 2013 Act]

Provisions Pertaining to Compromise, arrangement or Amalgamations are dealt with in section 230 to 240 of 2013 Act. Section 232 to 234 deals with merger and amalgamation. In Section 230 to 233, word 'Company' is used and there is no provision similar to section 394(4) of 1956 Act under 2013 Act.

Further, section 234 of 2013 Act deals with merger or amalgamation of company with foreign company and vice versa. Sub section (2) of section 234 states, 'subject to provisions of any other law for the time in force, a foreign company may with prior approval of RBI, merge into a Company Registered under this Act or vice versa'.

Explanation to sub section (2) of Section 234 of 2013 act states – 'the expression foreign company means any company or body corporate incorporated outside India whether having a place of business in India or not'.

1. Real Image LLP v. Qube Cinema Technologies Pvt. Ltd., 2017 SCC OnLine NCLT 4215

Section 234(1) provides that provisions of Chapter XV of 2013 act, shall apply mutatis mutandis to scheme of merger and amalgamations between companies registered under this act [i.e. 2013 Act] and companies incorporated in jurisdiction of such countries as may be notified by Central Government.

Under section 2(20) of 2013 Act, term Company is defined to 'mean a company incorporated under this Act or under any previous company law'.

In this background, joint petition was filed for merger of Real Image LLP (transferor entity) with Qube Cinema Technologies Private Limited (transferee entity) [hereinafter referred to as Real Image LLP case].

Analysis of NCLT Chennai in Real Image LLP case

While allowing the merger of LLP into Company, bench relied on following arguments –

1. Legislative intent behind enacting both LLP act of 2008 and Companies Act 2013, is to facilitate the ease of doing business and create desirable atmosphere for companies and LLPs. For this purpose, both the acts have provided provisions for merger or amalgamation of two or more LLP and Companies.
2. Whether Transferee / Transferor company needs to be company [registered under 2013 Act or any previous company law] or can it be entity other than company has been categorically dealt with under 1956 Act, however there is no specific provision in 2013 Act. [refer section 394(4) of 1956 Act]
3. If the intention of parliament is to permit a foreign LLP to merge with Indian Company [p.s. section 234 of 2013 Act, not only permits merger of foreign company but also foreign LLP into Company and vice versa], then it would be wrong to presume that the Act prohibits merger of any Indian LLP with Indian Company.
4. There does not appear any express bar to allow / sanction of merger of Indian LLP with Indian Company.
5. This is a clear case of 'casus omissus'.

What is *'casus omissus'*?

Meaning of the Latin phrase *Casus omissus* is - a situation omitted from or not provided for by statute or regulation and therefore governed by the common law.

Casus Omissus is an important principle of Interpretation of statutes. It is well settled that, a *casus omissus* cannot be supplied by the Court except in the case of clear necessity and when the reason for it is found in the four corners of statute itself.

Traditional Rule is that court cannot read anything into statutory provision which is plain and unambiguous and the legislative casus omissus cannot be supplied by judicial interpretative process *[Prakash Nath Khanna v. CIT (2004)].*[2]

The first and primary role of construction is that the intention of the legislature must be found in the words used by the legislature itself. If the words used are capable of one construction only, then it would not be open to the Courts to adopt any other hypothetical construction on the ground that such hypothetical construction is more consistent with alleged object and policy of the Act. *[Satheedevi vs. Prassana 2010 AIR SCW 3754].*

Courts cannot supply words which the legislature might have deliberately omitted. *[Delhi Financial Corporation vs. Rajiv Anand [2006] 131 comp cas 285 (SC)*

However modern trend is not so strict. In *Inco Europe v. First Choice Distribution*[3], this modern approach was elucidated as follows:

'It has been long established that the role of the courts in construing legislation is not confined to resolving ambiguities in statutory language. The Court must be able to correct obvious drafting errors. In suitable cases, in discharging

2. Prakash Nath Khanna v. CIT, (2004) 9 SCC 686
3. https://publications.parliament.uk/pa/ld199900/ldjudgmt/jd000309/inco.htm

its interpretative function the court will add words or omit words or substitute words.'

The questions which remain unanswered –

1. Ahmedabad High Court in the month of September 2017 [in case of Kediya Ceramics],[4] had dealt with similar situation where merger of Company and Partnership Firm was contemplated. In that judgement, NCLT Ahmedabad had discussed that (a) Partnership firm can be converted into company, (b) partnership firm can be considered as unregistered company, (c) partnership firm can be considered as body corporate. Definition of Company under SEBI Act, Depository Act AND Securities Contract Regulation Act includes body corporate, however company under Companies Act does not cover body corporate and therefore partnership firm cannot be considered as Company. Ahmedabad NCLT had not applied casus omissus principle. Apparently, Ahmedabad NCLT judgement was not referred in Real Image LLP Case.

2. Another principle of interpretation is, 'when the legislature has taken care to use different phrases in different sections, normally a different meaning is required to be assigned to the language used by the Legislature unless the context otherwise requires.' Since 2013 Act has defined words 'company', 'body corporate' and 'foreign company' under section 2 of the Act 2013, rather than using the word 'company' word 'body corporate' could have been used. OR an explanation similar to explanation inserted under section 234(2) could have been inserted. Or provision like sub section (4) of section 394 of 1956 Act could have been used. This fact is not discussed in Real Image LLP judgement so it is unknown whether these facts were brought to the notice of Chennai Bench or not.

3. Further, section 2 which is definition section of 2013 Act, starts with a disclaimer (like every other act) that – 'In this Act, unless the context otherwise requires'. This means defined words may have different meaning if the context so requires. Whether there were any arguments in the judgement of Real Image LLP case, on these grounds is unknown.

4. Dissolution of LLP is regulated under LLP Act, 2008, and whether those provisions were discussed or not is not getting reflected in the judgment.

5. As per rule 11 of National Company Law Tribunal Rules, 2016, NCLT has inherent powers to make such orders as may be necessary for meeting the ends of justice or to prevent abuse of the process of the Tribunal. However in erstwhile regulation 44 of Company Law Board Regulations, 1991, in *Shree Hari Agro Industries Ltd. and Ors. vs. Deepak Vegpro Private Limited and Ors.* it was held that 'such powers has to be exercised by the CLB in aid of and not de hors the provisions of the statute and in any event such exercise of powers conferred by regulation 44 cannot override the provisions of the Statute.

Conclusion

Undoubtedly, 2013 Act has lot of initiatives towards ease of doing business. It is absurd that under 2013 Act, merger of foreign body corporate into Indian Company or vice versa is specifically allowed, whereas no such corresponding provisions exists with respect to merger of Indian Body Corporate into Company and vice versa. There have been occasions in 2013 Act where word 'Company' is used but it is considered as body corporate eg. Definition of word 'financial year' uses the word company incorporated outside India. Whereas if incorporated outside India it cannot be company registered under Companies Act, 2013. Hence it is very much possible that the word Company sometimes includes even body corporate.

To settle this dust down, and to bring ease in merger and amalgamation, it is desirable to have suitable specific provisions not only under Companies Act 2013 but also in LLP Act, Income Tax Act, Stamp Act, Foreign Exchange Management Act and such other laws.

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4. Kediya Ceramics, In re, 2017 SCC OnLine NCLT 8327

 

CA Siddharth Banwat and CA Kush Vatsaraj

Related Party Transactions

Introduction

A Related Party Transaction (RPT) refers to a transaction between two parties who are joined by a special relationship prior to the transaction. The transaction would include any arrangement for provision of goods or service, a single or a series of financial contracts, or an arrangement. The parties involved on the two sides of the transaction can be related to each other in various forms. The common forms of relations between entities are parent-subsidiary, associate, affiliate, joint venture, entities under common control, entities controlled through relatives, the directors or the management of the company. RPTs are a) recognised in corporate and taxation laws; b) they have their own standards for accounting and c) systems of checks and balances have been built around them to make sure they are conducted within these boundaries.

Corporate governance, transparency in ownership structures has attained importance around the world under the garb of Base Erosion Profit Shifting and Exchange of Information initiatives. Indian regulators and authorities closely follow developments around the world and periodically introduce some of the best practices followed or introduced in other countries.

Controlling stakeholders indulge in various forms of such intra-group dealings, such as executive perquisites, compensation, transfer pricing, appropriation of corporate opportunities, and self-serving financial transactions such as directed equity issuance or loans to insiders, and misappropriation of corporate assets. Governments all over the world have proactively taken steps to monitor and prevent such self-dealings in the form of disclosures, approvals, or even outright restriction on such transactions. OECD has also provided guidelines on legislative and regulatory approaches for monitoring and preventing abusive related party. The disclosure of an entity's transactions, outstanding balances (including commitments), and relationships with related parties are important for the investor.

OECD has published a report on Related Party Transactions and Minority Shareholder Rights in the year 2012 which focused on the corporate governance framework that manages Related Party Transactions with the aim to protect minority investors. It covered over 30 jurisdictions, including in-depth reviews of Belgium, France, Israel, Italy and India. In this report it was observed that *"the five countries (especially India and Italy) all indicate a high level of RPTs with either controlling shareholders or affiliated companies. The key transactions vary over time but financing operations, credit guarantees, transfers of property, etc., are particularly important although recurring transactions at "market prices" involving goods and services might be under-reported due to reporting thresholds and exemptions for those on "market terms". The five jurisdictions only ban some RPTs such as loans to directors and the placement of new securities. They therefore implicitly accept that such transactions can be legitimate and raise efficiency, particularly in company groups. That means that suitable policies must be in place to manage and approve RPTs."*

Regulations related to RPTs are found in the Companies Act, 2013, Accounting Standard 18 (AS 18), the Indian Accounting Standard 24 (Ind AS 24), the Company Auditors Report Order (CARO), Clause 49 of the Listing Agreement, Insolvency and Bankruptcy Code, Goods & Services Tax Act. The Income-tax Act, 1961 also contains provisions related to transfer pricing (for international transactions) and specified domestic transactions on similar footing. These regulations and provisions are discussed in the following sections.

Definition of Related Party

There are various laws that require 'related parties' to be defined or described. Some of the places where 'related parties' and similar relationships are dealt with include:

- Companies Act, 2013 [related parties, relative, associated company]
- Income-tax Act, 1961 [associated enterprise, significant influence, arm's length]
- Insolvency & Bankruptcy Code
- Goods & Services Tax Act
- Foreign Exchange Management Act, 1999
- Various SEBI-issued regulations [insider trading, persons acting in concert]
- Indian Succession Act, 1925
- Competition Commission of India [collusion]

The various laws that need to consider and regulate transactions between related parties in principle cover the following:

- Identification of related parties
- Disclosure of related parties
- Identification of transactions with related parties
- Disclosure of transactions with related parties
- Require that unrelated interested parties affected by the transaction are consulted and protected
- Identification of transactions that are liable to be undertaken to regarded as contravening e a provision of the law, or defeat or circumvent a purpose or spirit of the law, or obtain some unjust enrichment or advantage
- Direct related parties to transact in a way that is not detrimental or prejudicial to the interests of certain other parties
- Prohibit certain transactions that are against public interest

Compliances & regulations with respect to Related Parties

The intention of the law is not to prevent related parties from entering into transactions; it is to ensure that when related parties transact, no other person is unjustly and unreasonably affected by such transaction(s). There must be a balance between the protecting various stakeholders while not unfairly burdening or impeding the conduct of commerce.

There are various compliances, both formal and substantive, which parties have to undertake while transacting with related parties.

Companies Act, 2013

The Companies Act, 2013 regulates the transactions entered into by a Company with its related parties. With the increase in the number of transactions within a corporate group, the provisions of the Companies Act also bring out the principle of arm's length pricing for transactions between the company and its related parties. In other words, a transaction will be considered to be undertaken at arm's length if the conduct between the two related parties takes place as though they were unrelated and there is no conflict of interest.

As per section 2(76) of the Companies Act, 2013 the term 'related party' with reference to a Company has been defined to mean:

a) directors or Key Managerial Persons and his/her relative;

b) firm or private company where director/ manager or their relative is a partner, member or director

c) a public company in which a director and manager is a director and holds along with his relatives, more than two per cent of its paid-up share capital;

d) any body-corporate whose Board of Directors, managing director or manager is accustomed to act in accordance with the advice, directions or instructions of a director or manager[#1];

e) any person on whose advice, directions or instructions a director or manager[#1] is accustomed to act;

f) any body-corporate which is holding, subsidiary or an associate company of such company or a subsidiary of a holding company to which it is also a subsidiary or an investing company or venture of the Company;

"*an investing company or the venturer of the company*" will mean a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate.

([#1]Except if in a professional capacity)

Section 188 of the Companies Act 2013 casts the responsibility on the Company to discuss and approve related party transactions that are proposed to be entered into by way of special resolution where the thresholds prescribed have been exceeded. For the purpose of section 188 of Companies Act, 2013 related party transactions include:

a) Sale, purchase or supply of any **goods or materials**;

b) Avail or render **any services**;

c) **Appointment of any agent** for purchase/ sale of any goods, materials or services;

d) Sale, buy, lease or dispose of **any property**;

e) Underwriting the subscription of any securities or derivatives;

f) Such related party's appointment to any office or place of profit in the company, subsidiary or associate company.

The section clarifies that such approval for related party transaction shall not be required if the transaction is entered into by the company in the ordinary course of business and such transaction is at an arm's length. This principle of 'arm's length' is seen under the transfer pricing provisions under the Income-tax Act, 1961 which aims to determine whether international transactions entered into by associated enterprises are at an arm's length. While the Companies Act, 2013 does not prescribe any methodology to determine the arm's length standard of a transaction, one may consider the application of the arm's length methodology under transfer pricing provisions to determine the fair price.

The phrase "ordinary course of business" used for this purpose is not defined under the Companies Act or rules made thereunder. It seems that the ordinary course of business will cover the usual transactions, customs and practices of a business and of a company.

However, the Allahabad High Court[1] has observed that for a transaction to be construed to have occurred in the ordinary course of business, there must be "an element of continuity and habit for it to constitute the exercise of a profession and business." However, the frequency of transactions over a period of time cannot be the only factor and it cannot be restricted to the core business activities of a company alone. Other activities such as support services that do not form part of the main core activity of a business, but are necessary and ancillary for running the core business, should also be considered as transactions that happen during the ordinary course of business. The assessment of whether a transaction entered was is the ordinary course of business is very subjective and should be decided on a case-to-case basis giving consideration to nature of business and objects of the entity.

The law also requires that all related party transactions need to be approved by the Audit Committee. The Audit Committee is also empowered to give an 'omnibus' approval for transactions up to ₹ 1 crore i.e., a pre-approval for all related party transactions proposed to be entered into by the company during a financial year subject to certain criteria to be defined by the Audit Committee. These criteria include the names of the parties with which the transactions can be entered into, the maximum value per transactions and of all the transaction in aggregate that can be entered into during the year, the manner of disclosures to be made and review of transactions undertaken at regular intervals. Such omnibus approval cannot be given for transactions that entail sale or disposal of an undertaking of the company.

It should be noted that the Companies Act does not clarify whether related party transactions must be first approved by the Board or the Audit Committee. If the Board approves a transaction, but the Audit Committee withholds consent it would pose challenges to the company, therefore, such transactions should ideally be approved by the Audit Committee first and then by the Board.

Further, the law also provides that if the transactions entered into exceed a certain threshold, shareholder's approval shall also be required by way of an ordinary resolution. The thresholds for each type of transaction are tabulated below:

Type of transaction(s)	**Prescribed threshold (i.e. if the value of transaction)**
• Sale, purchase or supply of any goods or materials • Avail or render any services • Appointment of any agent for purchase/sale of any goods or materials or services	Exceeds 10% of turnover; or ₹ 100 crore for goods; ₹ 50 crore for services, whichever is lower
Sale, buy, lease or dispose of any property	Exceeds 10% of net worth or ₹ 100 crore, whichever is lower
Underwriting the subscription of any securities or derivatives	Exceeds 1% of net worth
Such related party's appointment to any office or place of profit in the company, subsidiary or associate company.	Exceeds ₹ 2,50,000 per month

1 *Ram Sarup v. Tika Ram Vakil (1919) 6 AIR 11-13*

Further, if a contract is not approved/ratified by the Board or Shareholders within three months, such contract shall be voidable at the option of the Board/ Shareholders. Also, if an unratified transaction was entered into with a director's related party or authorised by a director, such director shall indemnify the company against the loss.

The Companies Act also provides that when such transactions are being approved, interested members/directors are prohibited from voting on such resolutions unless 90% or more of the members, by number, are relatives of the promoter or related parties.

If a director or employee enters into a transaction in contravention of the provisions of section 188, the law provides for a fine of ₹ 25,000 to ₹ 500,000 and imprisonment of up to 1 year (in case of listed companies). Further, under section 164, a director who has been convicted for contravening section 188, he is disqualified from being appointed as a director for a period of 5 years post such conviction.

The Companies Act, through section 184, requires that every director must disclose his concern or interest in any company or companies or bodies corporate, firms, or other association of individuals which shall include the shareholding in prescribed manner. A director with such concern or interest must disclose his interest when a contract with such party is being discussed and he shall not participate in such meeting. If any director becomes concerned or interested in an entity with which a contract or arrangement exists, he shall disclose his interest in the first Board Meeting held after he becomes so interested. If a director does not disclose his interest and a contract is entered into with such an entity, the contract shall be voidable at the option of the Company. A director contravening this section shall be punishable with imprisonment for up to one year or with fine which may extend to one lakh rupees, or with both.

In addition to the above disclosure and approval requirements the Act also requires the Board to provide a justification for entering into every such contract or arrangement in its report to the shareholders. The company must also maintain a register, in which all transactions above a prescribed threshold value in respect of contracts/arrangements, in which directors are interested, should be entered. The register should be kept at registered office of the company and should be open to inspection to all members.

While the above restrictions applied to the company and its conduct, the Companies Act also has placed restrictions on persons from becoming auditors of a company, to ensure that no one with a conflict can be appointed as an auditor. Section 141 lays down that the following persons will be disqualified from being appointed as auditors of a company:

- a person who himself or whose relative or partner
  - holds any security of or interest in the company or its holding, subsidiary or associate company or sister concern
  - is indebted to the company or its holding, subsidiary or associate company or sister concern in excess of prescribed amount
  - has given a guarantee or provided any security in connection with the indebtedness of any third person to the company or its holding, subsidiary or associate company or sister concern exceeding a prescribed amount.
- a person or a firm who, directly or indirectly, has business relationship with the company or its holding, subsidiary or associate company or sister concern of prescribed nature
- a person whose relative is a director/ KMP

Account Standard 18 – Related Party Disclosures

The Accounting Standard 18 (AS 18) covers the disclosure requirement in respect of RPTs undertaken by a company. For the purpose of AS 18, two parties are considered to be related to each other if one party has the ability to control the other party, or if one party can significantly influence the other in making financial and/or operating decisions in a particular reporting period.

AS 18 does not mandate a specific format for how to report RPTs. It however, provides for aggregating these transactions when they are too numerous. Only those transactions that pass the materiality test — those that are 10% or in excess of the monetary value of the total transactions of the same nature — are exempted from aggregation.

The requirement of disclosure of RPTs in the financial statements includes

(i) the name of the transacting related party

(ii) a description of the relationship between the parties

(iii) a description of the nature of transactions undertaken

(iv) the volume of the transactions either as an amount or as an appropriate proportion

(v) any other elements of the RPTs necessary for understanding the financial statements, &

(vi) the amounts or appropriate proportions of outstanding items.

Indian Accounting Standard (Ind AS) 24 – Related Party Disclosures

Ind AS 24's main objective is to ensure that appropriate disclosures are made in the financial statements *"to draw attention to the possibility that its financial position and profit or loss may have been affected by the existence of related parties and by transactions and outstanding balances, including commitments, with such parties"*.

Accordingly, Ind AS 24, similar to AS 18, requires reporting entities to identify related parties and disclose details of the transactions undertaken with such parties in the financial statements.

For governing the determination and identification of related party relationship, Ind AS 24 has provided the following definitions:

Related Parties

(a) A person or a close member of that person's family is related to a reporting entity if that person:

(i) has control or joint control of the reporting entity;

(ii) has significant influence over the reporting entity; or

(iii) is a KMP of the reporting entity or of a parent of the reporting entity.

(b) An entity is related to a reporting entity if any of the following conditions apply:

(i) The entity and the reporting entity are members of the same group (which means that each parent, subsidiary and fellow subsidiary is related to the others).

(ii) One entity is an associate or joint venture of the other entity (or an associate or joint venture of a member of a group of which the other entity is a member).

(iii) Both entities are joint ventures of the same third party.

(iv) One entity is a joint venture of a third entity and the other entity is an associate of the third entity.

(v) The entity is a post-employment benefit plan for the benefit of employees of either the reporting entity or an entity related to the reporting entity. If the reporting entity is itself such a plan, the sponsoring employers are also related to the reporting entity.

(vi) The entity is controlled or jointly controlled by a person identified in (a).

(vii) A person identified (a)(i) has significant influence over the entity or is a member of the KMP of the entity (or of a parent of the entity).

(viii) The entity, or any member of a group of which it is a part, provides KMP services

Further, **close members of the family** of a person are the family members who may be expected to influence or be influenced by that person in their dealings with the entity, including:

(a) that person's children, spouse or domestic partner, brother, sister, father and mother;

(b) children of that person's spouse or domestic partner; and

(c) dependants of that person or that person's spouse or domestic partner.

Income-tax Act, 1961 (ITA)

The ITA deals with transactions between related parties in various provisions. Certain provisions exempt certain transactions from giving rise to taxable income if they are entered into between related parties, such as gift between relatives or transfer of assets between an Indian holding company and its subsidiary etc.

Specifically, related party transactions as being discussed in this Article are dealt with under Section 40A(2) of the ITA and under the Transfer Pricing provisions of the ITA.

Section 40A(2) provides for disallowance of expenditure, if in respect of such expenditure payment is made or to be certain related persons of the payer, and the Assessing Officer is of opinion that such expenditure is excessive or unreasonable. For the purpose of section 40A(2), related persons are described to include:

- Relative of an individual
- director of the company, partner of the firm, or member of the association or family, or any relative of such director, partner or member.
- an individual or his relative, or a company (or director) or firm (or partner) or AOP/ HUF (or member) if such person has substantial interest in assesses or relative's biz/prof.
- a person if an individual or his relative, or a company (or director) or firm (or partner) or AOP/ HUF (or member) has substantial interest in such person's business.

The transfer pricing provisions (TP provisions) are given in sections 92 to 92F and 94B of the ITA. They cover international transactions, i.e., transactions between related parties where at least one party is a non-resident, and specified domestic transactions (SDTs), i.e., certain transactions where the entity in question or one of the entities is availing certain activity-linked profit exemptions under the ITA.

It is interesting to note that the TP provisions with respect to SDTs cover cases where there are internal transactions within a single entity but between a unit that is eligible for certain tax emptions and another unit within that entity.

TP provisions require that transactions between AEs are undertaken at an 'arm's length price' (ALP) i.e., is in a manner that is consistent with the conduct between two unrelated parties in similar circumstances. The provisions provide for methods to determine the ALP and criteria on how to choose and apply such methods.

If a transaction between two AEs is found to have taken place at a price that differs from the ALP and such deviation results in a loss to the Revenue, an appropriate adjustment is made to the prices by disallowing certain portion of the expenditure claimed or increased the income that is offered to tax.

The TP provisions also, do not cover transactions between related parties but transactions between "associated enterprises", a definition that it is different in scope than 'related parties'.

Associated enterprises (AEs) would include the following persons or entities:

- that participate directly or indirectly in the management or control or capital of the other enterprise (which means he has at least 26% direct or indirect voting power) and
- which are controlled or managed by the same person or entity
- has advanced loans of more than 51% of book value of assets or guaranteed 10% or more of total borrowings
- appoints majority directors or 1 or more executive directors
- on whom the operations, through provision of intellectual property rights or supply of raw material are wholly dependent, or
- the goods manufactured or processed by one enterprise, are sold to the other enterprise and the prices and other conditions relating thereto are influenced by such other enterprise
- are controlled by an individual and the other enterprise by him or his relative.
- an individual who, alone or with his relatives, controls both enterprises
- a firm, AOP or BOI, in which the other enterprise holds 10% or more interest

The ITA also contains General Anti-Avoidance Rules that give sweeping powers to the tax authorities to disregard or characterise agreements between 'accommodating parties' that are deemed 'impermissible' and for the purpose of avoidance of taxes or are arrangements that lack commercial substance irrespective of the relationship between the entities. GAAR would cover transaction or contracts between relatives, associated enterprises, connected persons, and cases where there is substantial interest. Recently, Mumbai Bench of NCLT *vide* an order dated 5th September 2018 in case of Gabs Investments Private Limited rejected a scheme of merger considering the objections raised by the revenue invoking provisions of GAAR thereby introducing new facet of correlation of various laws.

Goods & Services Act

Other than avoidance of direct taxes, transactions with related parties can also be used to avoid or escape indirect taxes. Barter transactions or *quid pro quo* schemes between related parties can be deployed to deprive the Revenue of due taxes. Accordingly, Schedule I of the CGST Act provides that commercial transactions entered into between related persons, including import of services by a taxable person from a related person or any establishment outside India, shall be treated as supply even if made without consideration. Thus, even if related parties do no remunerate each other for commercial transactions, the liability to charge and pay GST on such transactions will arise.

For GST, persons are deemed to be related if they fall under any of the categories below:

- An officer or director of one business is the officer or director of another business
- An employer and an employee
- A person who directly or indirectly holds at least 25% shares in a company
- One person controls the other directly or indirectly

- Two persons are under common control or management
- The entities together control another entity
- Persons who are members of the same family

Persons who are associated with one another's business or are a sole agent or sole distributor or sole concessionaire will also be deemed to be related.

Clause 49 of Listing Agreement

Clause 49 of the Listing Agreement requires that the details of material individual transactions with related parties that are not in the normal course of business along with a statement of all RPTs should be placed before the audit committee.

Insolvency & Bankruptcy Code, 2016

The IBC which was introduced to streamline the insolvency and debt recovery process in India also deals with transactions between related persons. There are many ways in which related persons can enter into abusive transactions during insolvency proceedings and obtain unjust benefits at the cost of creditors or the company.

For the purposes of IBC, section 5(24) defines 'related parties' in relation to corporate debtors as under:

a) a director or partner or his relative

b) a KMP or his relative

c) an LLP or firm in which a director, partner, or manager of the corporate debtor or his relative is a partner

d) a private company in which a director, partner or manager of the corporate debtor is a director and holds along with his relatives, more than 2% share capital

e) a public company in which a director, partner or manager of the corporate debtor is a director and holds along with relatives, more than 2% of paid-up share capital

f) any body corporate, whose, Board, MD or manager, or LLP or firm whose partners or employees in the ordinary course of business, acts on the advice, directions or instructions of a director, partner or manager of the corporate debtor;

g) any person on whose advice, directions or instructions, a director, partner or manager of the corporate debtor is accustomed to act;

h) a body corporate which is a holding, subsidiary, or associate company or sister concern of the corporate debtor,

i) a person who controls more than 20% voting rights in the corporate debtor

j) any person in whom the corporate debtor controls more than 20% voting rights

k) any person who can control the composition of the Board or corresponding governing body of the corporate debtor

l) any person who is associated with the corporate debtor because he participates in the policy making processes, or has more than 2 common directors, or interchanges managerial personnel with, or provides or receives essential technical information to or from, the corporate debtor.

IBC, 2016 was amended *vide* The Insolvency and Bankruptcy Code (Amendment) Ordinance, 2018 dated 6th June, 2018 to balance the interests of various stakeholders. Accordingly, Section 5(24A) was inserted which defines 'related parties' in relation to an individual. As per the newly inserted section related parties in relation to an individual includes the followings:

a) a person who is a relative of the individual or a relative of the spouse of the individual;

b) a partner of a limited liability partnership, or a limited liability partnership or a partnership firm, in which the individual is a partner;

c) a person who is a trustee of a trust in which the beneficiary of the trust includes the individual, or the terms of the trust confers a power on the trustee which may be exercised for the benefit of the individual;

d) a private company in which the individual is a director and holds along with his relatives, more than two per cent. of its share capital;

e) a public company in which the individual is a director and holds along with relatives, more than two per cent. of its paid-up share capital;

f) a body corporate whose board of directors, managing director or manager, in the ordinary course of business, acts on the advice, directions or instructions of the individual;

g) a limited liability partnership or a partnership firm whose partners or employees in the ordinary course of business, act on the advice, directions or instructions of the individual;

h) a person on whose advice, directions or instructions, the individual is accustomed to act;

i) a company, where the individual or the individual along with its related party, own more than fifty per cent of the share capital of the company or controls the appointment of the board of directors of the company.

For the purpose of this definition, the term 'relative' with reference to any person has been very widely defined to mean anyone who is related to another, in the following manner, namely:

a) members of a Hindu Undivided Family,

b) husband,

c) wife,

d) father,

e) mother,

f) son,

g) daughter,

h) son's daughter and son,

i) daughter's daughter and son,

j) grandson's daughter and son,

k) granddaughter's daughter and son,

l) brother,

m) sister,

n) brother's son and daughter,

o) sister's son and daughter,

p) father's father and mother,

q) mother's father and mother,

r) father's brother and sister,

s) mother's brother and sister; and

t) wherever the relation is that of a son, daughter, sister or brother, their spouses shall also be included.

Further, section 28 of the IBC, 2016 provides that without prior approval of the committee of creditors, the resolution professional cannot enter into any related party transactions so as to prevent any undue advantage or misuse of insolvency proceedings. Section 21 of the IBC prevents a related party to whom a corporate debtor owes a financial debt from having any right of representation, participation or voting in a meeting of the committee of creditors that is constituted by the interim resolution professional after the collation of all claims.

It is possible that a company, in the period prior to going into insolvency proceedings undertook transactions that were under or overvalued to it determine in order to provide benefits to certain persons. Further, even though the company would not have been paying some creditors, it may have unfairly given preferential treatment to certain persons in discharging their debts. To tackle such cases, the IBC has defined what transaction will be considered preferential or undervalued and also provides for the reversal or undoing or avoidance of such transactions in various circumstances.

Section 43 provides that any transactions that was undertaken with related parties within a period of 2 years prior to the commencement of the insolvency resolution proceedings will be considered as being preferential in nature.

Section 44 of the IBC allows for transactions to be undone or the undue benefit to re-vest in the corporate debtor undergoing the insolvency proceedings. Further, a situation can exist that some person acquires some property from a person who has received benefit through a preferential transaction with a corporate debtor. Section 44 also provides that if such other person had sufficient intimation that the corporate debtor was undergoing insolvency proceedings or is a related party of, it shall be assumed that the transaction was not undertaken in good faith.

Sections 46 and 47 provide that if prior transactions with related parties are shown to be undervalued, they can be declared void and reversed.

Sections 29A of the IBC, 2016 debars persons who are not eligible to be resolution applicant in the Corporate Insolvency Resolution Process. Section 29A was introduced into the IBC recently to prevent persons with conflicts of interest from proposing resolution plans. Clauses (a) to (i) of Section 29A of the IBC render certain persons who may have conflicts ineligible to submit a resolution plan. Clause (j) to Section 29A further provides that even 'connected persons' of such ineligible persons are ineligible from submitting a resolution plan during the insolvency resolution process.

For this purpose, 'connected persons' are defined as:

a) any person who is the promoter or in the management or control of the resolution applicant; or

b) any person who shall be the promoter or in management or control of the business of the corporate debtor during the implementation of the resolution plan; or

the holding company, subsidiary company, associate company or related party of such above persons

Conclusion

In the present environment, where laws are evolving to insert greater transparency in the dealings of businesses, transactions between related parties will only be further scrutinised. The greater responsibility on directors and liability on professionals, and changes such as the notification of reporting requirements under the Companies Act, 2013 which require the identification of "Significant Beneficial Owners" of companies are making it less and less likely that related party transactions will be used to circumvent laws or obtain any unjust benefits.

The principle behind RPT disclosure is to have a framework of laws and rules that ensure that other than commercial benefits through synergy and collaboration, transactions between related parties do not have any loopholes available to exploit. As the cost of complying with various provisions and the disclosure requirements increase, unnecessary RPTs would be avoided. However, the law-makers and regulators should be mindful that the cost of compliance and disclosure requirements should not become prohibitive or restrictive to genuine transactions. In the event unreasonable restrictions being placed on private enterprises, there are legal remedies available; an environment of honest compliance with the law will ensure that the law-makers are receptive and sympathetic to the needs and problems faced by businesses. It is the role of professionals and business leaders to be aware of the changes in law and the direction it is taking and be proactive to such changes – where such developments are justified they should be complied with in spirit.

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Dharmesh Zaveri, *Company Secretary*

Privileges of Private Company and Small Company

What is Private Limited Company

A private company limited by shares provides us a good opportunity for operating and managing businesses so long as, generally, the activity in which it is engaged is small, the owners of the business are family members or friends related closely or otherwise associated with each other and the financial assistance required for managing the business is either exclusively provided by the members or partly managed by the members and partly from outside borrowings. There are many companies which are small and operate only for the interest of family members or of close associates. Their scope is limited to the extent of their business operations and they continue as private companies for a long time. In certain circumstances when a major project is proposed to be undertaken requiring large resources, the promoters may find it expedient first to register the company as a private limited one and opt to convert it into a public company at a suitable stage after incorporation. During the said interim period the promoters may find it easy and convenient to carry on its business operations as a private company in order to enjoy certain benefits available to private companies.

There are lot of benefits enjoyed by private companies over public companies in terms of applicability of provisions of the Companies Act, 2013 (the "Act"). The Central Government *vide* its notification dated 5th June 2015 and 13th June 2017 notified much awaited exemptions to private companies with the motive of promoting the Government's mantra – Ease of Doing Business. All such exemptions are provided with an intent of less filing burden and more liberalised approval process.

However, it is pertinent to note that the extended benefits of private companies available vide notification dated 5th June 2015 and 13th June 2017 are available only to those private companies who have not committed a default in filing its financial statements under section 137 of the said Act or annual return under section 92 of the said Act with the Registrar of Companies.

Definition of Private Company

Sec. 2(68)

Private company" means a company having a minimum paid-up share capital as may be prescribed, and which by its articles

(i) restricts the right to transfer its shares;

(ii) except in case of One Person Company, limits the number of its members to two hundred:

Provided that where two or more persons hold one or more shares in a company jointly, they shall, for the purposes of this clause, be treated as a single member:

Provided further that—

A. persons who are in the employment of the company; and

B. persons who, having been formerly in the employment of the company, were members of the company while in that employment and have continued to be members after the employment ceased, shall not be included in the number of members; and

(iii) prohibits any invitation to the public to subscribe for any securities of the company.

List of provisions of the Act which are not applicable to Private Companies

Section	Subject matter
2(40)	Financial statements of a private company which is a start-up company may not include a **cash flow statement.** *Explanation* – Start-up company means a private company recognised as start-up in accordance with the notification issued by the Department of Industrial Policy and Promotion, Ministry of Commerce and Industry. (Exemption available w.e.f. 13th June 2017) – The exemption is also available to one person/small/dormant company)
2(76) (viii)	2(76)- **Related Parties:** viii- Any (*body corporate) which is; A. a holding, subsidiary or an associate company of such company; B. a subsidiary of a holding company to which it is also a subsidiary; or C. *an investing company or the venturer of the company;" *Explanation*:- For the purpose of this clause, "the investing company or the venturer of a company" means a body corporate whose investment in the company would result in the company becoming an associate company of the body corporate. This provision is not applicable to private Company w.e.f. 5th June 2015. For any related party transaction, the above mentioned persons will not be considered as **Related Party** for compliance of Sec. 188 (related party transactions). *(amended w.e.f. 09/02/2018)
Rule 9A of Chapter II	Effective from 2nd October 2018 every unlisted Public Company shall: • Issue the securities only in dematerialised form; and • Facilitate dematerialisation of all its existing securities **Not applicable to Private Company.**

Section	Subject matter
43	The provision related to **kinds of share capital** do not apply to private company provided its Memorandum or Articles of Association has the provision of the same. (Exemption available w.e.f. 5th June 2015)
47	The provision related to **voting rights** do not apply to private company provided its Memorandum or Articles of Association has the provision of the same. (Exemption available w.e.f. 5th June 2015)
62(1) (a)(i) & 62(2)	The subject of consent of 90% of the members in writing or in electronic mode, **offer period of the right issue** can be lesser than 15 days and **notice period of right issue** can be lesser than 3 days in case of private company. (Exemption available w.e.f. 5th June 2015)
62(1)(b)	In case of a private company approval of members is required for issue of shares to employees under a scheme of **employees' stock option** by way of passing **ordinary resolution** instead of special resolution (Exemption available w.e.f. 5th June 2015)
67(2)	Restriction to **give loan or guarantee or to provide security** for the **purchase of its own share**s not applicable to a private company
73(2)(a) to (e)	Private companies are permitted to **borrow from members**, money up to 100% of aggregate of paid up share capital and free reserves however it has to file return of deposit with ROC. (Exemption available w.e.f. 5th June 2015) <u>Above referred exemption is substituted by following</u>; A private company 1) which accepts from its members monies not exceeding one hundred per cent of aggregate of the paid up share capital, free reserves and securities premium account; or 2) which is a start-up, for five years from the date of its incorporation; or 3) which fulfils all of the following conditions, namely:- a) which is not an associate or a subsidiary company of any other company; b) if the borrowings of such a company from banks or financial institutions or any body corporate is less than twice of its paid up share capital or fifty crore rupees, whichever is lower; and c) such a company has not defaulted in the repayment of such borrowings subsisting at the time of accepting deposits under this section. Provided such companies shall file prescribed return with ROC in respect of monies so borrowed. (Exemption available w.e.f. 13th June 2017)

Section	Subject matter
92(1)(g)	In case of Private Company, which is a small company, aggregate amount of **remuneration drawn** by Directors is not required to be disclosed in Annual Return. (Exemption available w.e.f. 13th June 2017)
Proviso to 92(1)	Annual Return of Start-up private company may be signed by the company secretary or where there is no company secretary, by the Director of the company only. (Exemption available w.e.f. 13th June 2017) – Exemption is also available to one person and small company.
93	A private company was not required to intimate changes in shareholding of promoters and others to the Registrar. (w.e.f. 13th June 2018 the provision of this section is omitted and now it is not applicable to any companies)
101 to 107 & 109	If anything otherwise mentioned under the Articles of Association of the company, then the **provisions related to general meeting** is not applicable to private company. (Exemption available w.e.f. 5th June 2015)
108	Provision related to **voting by electronic means** (e-voting) is not applicable to companies having 1000 shareholders or more. (Maximum Nos. of members of a Private Company is 200)
110	Provision related to **postal ballot** is not applicable to companies having members up to 200. (Maximum Nos. of members of a Private Company is 200)
117(3)(g) read with 179(3)	Private company is **exempted from filing Form MGT-14** to the Registrar of the company for the resolution passed under section 179(3). (Exemption available w.e.f. 5th June 2015)
120	Keeping **records in electronic form** is not applicable to companies having 1000 security holders or more. (Maximum Nos. of members of a Private Company is 200)
121	A private company is not required to file a **report** with the Registrar about its **annual general meeting.** (This provision is applicable to listed Public Company only)
134(3)(p)	Reporting requirement of **annual evaluation of the performance of the Board** and its Committees in Board's report is not applicable to Private Companies.
138	Appointment of **Internal auditor** is not applicable to those private companies whose turnover is less than 200 crores or outstanding loans or borrowings from banks or public financial institutions is less than 100 crore at any point of time during the preceding financial year.

Section	Subject matter
141(3)(g)	Private companies are **excluded from limit of 20 companies to be audited** by any auditor. (Exemption available w.e.f. 5th June 2015)
143(3)(i)	Private Company which has a turnover of less than ₹ 50 crore as per the latest Audited Financial Statements or which has an aggregate borrowing from Banks or Financial institutions or any Body Corporate at any point of time during the financial year less than ₹ 25 crore is exempted from **reporting on adequacy of internal financial controls** system and operating effectiveness of such controls by the auditor in their Auditor's Report. (Exemption available w.e.f. 13th June 2017) – Exemption is also available to one person and small company.
149(1)	The provision for appointment of **woman director** is not applicable to private company.
149(4)	The provision for appointment of **independent director** is not applicable to private company.
152(6)	The provision of **retirement of Directors by rotation** is not applicable to a private company.
160	Provisions related to right of persons other than retiring Directors to stand for Directorship is not applicable for private company. (Exemption available w.e.f. 5th June 2015)
161(4)	The provision of **casual vacancy of Director** was not applicable to a private company. (Effective from 9th February 2018 the provision is applicable to all companies)
162	Provision related to passing of separate resolution for appointment of more than 1 director is not applicable to a private company. (Exemption available w.e.f. 5th June 2015)
173(5)	Provision related to **meeting of board** is deemed to be complied with for private start-up company if at least one meeting of Board of Directors has been conducted in each half of the financial year, and the gap between the two meetings is not less than ninety days. (Exemption available w.e.f. 13th June 2017)- Exemption is also available to one person/ small/dormant company)
174(3)	In case of private company **interested director may also be counted towards quorum** in such meeting after giving disclosure of his interest pursuant to section 184. (Exemption available w.e.f. 13th June 2017)
177 & 178	Constitution of **Audit Committee** and **Nomination & Remuneration Committee** is not applicable to a private company.
178(5)	Constitution of **Stakeholders Relationship Committee** is not applicable to companies having 1000 security holders or more. (Maximum Nos. of members of a Private Company is 200)

<table>
<tr><th>Section</th><th>Subject matter</th></tr>
<tr><td>180</td><td>Approval of members is not required for a private company in case of following:
• Sale/lease/dispose of whole or substantially whole of undertaking
• Invest amount of compensation received as a result of merger or amalgamation
• Borrow money in excee of paid up capital and free reserves
• Remit, or give time for the repayment of, any debt due from a director
(Exemption available w.e.f. 5th June 2015)</td></tr>
<tr><td>184(2)</td><td>In case of private company interested director is permitted to participate, provided appropriate disclosure of interest is given to the Board.
(Exemption available w.e.f. 5th June 2015)</td></tr>
<tr><td>185</td><td>➢ The provision related to Loans to Directors is not applicable to Private Company subject to fulfilling of all the three conditions mentioned below:
• No body corporate shareholder in the Company
• Borrowings from Banks / Financial Institutions / any Body Corporate is less than
– Two times of the paid-up share capital OR
– 50 crore
Whichever is lower.
• No default in repayment of borrowings subsisting at the time of granting loans
(Exemption available w.e.f. 5th June 2015 and effective till 6th May 2018)
➢ Effective from 7th May 2018 no Company can provide any loan/guarantee/security to (i) any director; (ii) any Director of the Holding Company; (iii) any partner or relative of such director; and (iv) any firm in which such director is a partner or relative.
➢ Any Company can give loan/guarantee/security to any person in whom any of the Director of the Company is interested subject to following conditions:
• Special Resolution is passed (explanatory statement shall include full particulars and purpose of the said resolution)
• Loans are utilised only for its principal Business Activities.
➢ Person in whom any of the Director of the Company is interested means:
• Private Company of which such person in Director / Member; or
• Body Corporate of which > 25% of voting power is controlled by such person(s); or
• Body Corporate / Board / MD / Manager is accustomed to act in accordance with directions of the Board / any of the director(s) of the Lending Company.</td></tr>
</table>

Section	Subject matter
188(1)-2nd Proviso	Restriction on **voting by members being a related party** on resolution to be passed in respect of related party transaction is not applicable to private company. (Exemption available w.e.f. 5th June 2015)
190(4)	Keeping copies of contract of service with Managing Director/Whole-time Director not applicable to a private company.
196(4) & (5)	Approval of Board for appointment and terms and conditions of appointment including remuneration of managerial personnel is not applicable to private company. (Exemption available w.e.f. 5th June 2015)
197(1)	Maximum limit of 11% of managerial remuneration not applicable to a private company.
203	Provision related to appointment of key managerial person (MD/ WTD/ CFO) is not applicable to private company. (Private Company having paid-up capital of ₹ five crores or more shall have whole-time Company Secretary)
204	Provision related to **Secretarial Audit** and submission of secretarial audit report is not applicable to private company.

What is Small Company

The concept of small company has been introduced first time in the Companies Act, 2013. Small company is identified under the Act based on its capital and turnover for the purpose of availing some relief/ exemption.

Definition of small company

Sec. 2(85)

Small company" means a company, other than a public company-

(i) paid-up share capital of which does not exceed fifty lakh rupees or such higher amount as may be prescribed which shall not be more than ten crore rupees; and

(ii) turnover of which as per profit and loss account for the immediately preceding financial year does not exceed two crore rupees or such higher amount as may be prescribed which shall not be more than one hundred crore rupees:

Provided that nothing in this clause shall apply to —

A. a holding company or a subsidiary company

B. a company registered under section 8; or

C. a company or body corporate governed by any special Act

From the above it is clear that even though any holding or subsidiary fulfils condition of small company in terms of paid-up capital or turnover it is excluded from the definition of small company. Similarly a company may classify as small company in a particular year but may not classify as small company in any subsequent year but again it can classify as small company in any year upon fulfilment of prescribed condition.

Small company being private company it enjoys most of the benefits available to private company as far as it comply with the specified paid-up and turnover requirements.

Anoj Menon, *Solicitor & Advocate*

Analysis of the Order/Judgment dated August 3, 2018 passed by the Hon'ble High Court of Madras in the matter of Bhagavan Das Dhananjaya Das versus Union of India and Anr.

The latest ruling from the Madras High Court *(delivered on August 3, 2018)* in the case of *Bhagavan Das Dhananjaya Das versus Union of India and Anr. [2018] 96 taxmann.com 189 (Madras)* has added a new dimension to the hotly debated and adjudicated question regarding director disqualification under Section 164(2)(a) of the Companies Act, 2013 ("the Act"), *viz.*, that a director ought to be given an opportunity of personal hearing, in terms of the principles of natural justice, before he/she is declared as disqualified from the boards of other companies where he/she is a director.

Background

The petitioner in this case was a director of a private company *(Birdies and Eagles Sports Technology Private Limited ("Birdies")),* which was issued a show cause notice by the Registrar of Companies ("ROC") under Section 248(1) of the Act, for striking-off its name from the register of companies, for non-filing of annual returns for a continuous period of three financial years. Birdies had no objection to such strike off. Consequently, Birdies was struck off from the Register of Companies by the ROC, *vide* a Gazette notification. Additionally, a separate list was also released by the ROC disqualifying even the directors of Birdies (including the petitioner) under Section 164(2)(a) of the Act. Hence, the petitioner stood disqualified from being appointed or reappointed as director in any other company for a period of five years.

Under the earlier regime (Companies Act, 1956 ("1956 Act")), Section 274(1)(g) provided for disqualification of directors, due to the default of the company with which the director was associated. However, Section 274(1)(g) applied only if the company in question was a public company. Section 164(2) of the Act, which effectively replaced Section 274(1)(g) (from March 31, 2014), applies both to a public as well as a private company. Further, Section 274(1)(g) was expressly given retrospective effect by the legislature: though the said Section was inserted by the Companies (Amendment) Act, 2000 with effect from December 13, 2000, it stipulated that the 3-year period be calculated from April 1, 1999. In the case of Section 164(2), there is no express provision making it retrospectively applicable.

Birdies, a private company, had omitted to file its returns, even under the old regime. However, since Section 274(1)(g) did not apply to a private company, the omission in filing annual returns under the old regime (i.e., until March 31, 2014) could not have attracted the disqualification consequence for its directors, hence non-filings for the year 2013-14 should not have been reckoned for calculating the 3-year period. This was the main thrust of the arguments advanced by the petitioner before the Madras High Court.

It was also argued that the provisions of Section 164(2)(a) ought to be given prospective application; and cannot be made applicable retrospectively, so as to disqualify directors for omissions, which were not grounds for disqualification earlier under the 1956 Act. The petitioner also argued that the directors ought to have been given a personal hearing by the ROC, before the ROC, disqualified them under Section 164(2)(a) of the Act.

Findings

The Madras High Court in its judgment has agreed with the contentions of the petitioner. It has held that (i) unless a contrary intention appears from a legislation, such legislation is to be presumed not to be intended to have retrospective operation; (ii) the General Circular No. 08/14 dated April 4, 2014 earlier issued by the Ministry of Corporate Affairs was unambiguous that filings, etc., in respect of the financial years prior to April 1, 2014 were to be governed by the relevant provisions of the 1956 Act; and the provisions of the Act, would apply only for financial years commencing after April 1, 2014; (iii) since Birdies was a private company, the disqualification of its directors (including the petitioner), would be triggered only for defaults in the company's filings for the financial years 2014-15, 2015-16 & 2016-17 (after taking into account the 270 day additional period available to make delayed filings under Section 403 of the Act); (iv) since the ROC had taken into account the omissions in filing also for the financial year 2013-14, i.e. one year before the Act came into force, for the purpose of disqualifying Birdies' directors, the entire process of disqualification was vitiated.

Significantly, the Madras High Court also accepted the petitioner's arguments that before disqualifying *inter alia* the Petitioner, the ROC ought to have observed the principles of natural justice, that notice of personal hearing ought to have been issued to the Petitioner; and the Petitioner should have been heard. This is primarily on the ground that such disqualification takes away the ability of a director to be a director of other companies as well, even if such companies are compliant in its filings – hence extinguishing the corporate life of such director. It is significant to note that, even though Section 164(2)(a) was not challenged by the petitioner, the Madras High Court read down this provision (since the statutory consequence was disproportionate to the lapse), to require prior notice to be issued, into what is otherwise a consequence by operation of law.

In arriving at its conclusion, the Madras High Court referred to previous decisions of the Supreme Court, which were to the following effect:

- The aim of the rules of natural justice is to secure justice, or to put it negatively to prevent a miscarriage of justice; these rules do not supplant the law of the land but supplement it;
- When a statute is silent, with no positive words in the Act or the Rules spelling out the need to hear the party, whose rights or interests are likely to be affected, the requirement to follow a fair procedure before taking a decision must be read into the statute, unless the statute otherwise provides;
- There may be instances where an authority is vested with the powers to pass orders, which would affect the liberty or property of an individual, but the statute may not contain a provision for prior hearing;

but the applicability of the principles of natural justice is not dependent upon any statutory provision. This principle has to be mandatorily applied irrespective of the fact as to whether there is any such statutory provision or not;

- These principles of natural justice also extend to and are applicable to the administrative actions of the State.

An additional factual matter here was that the name of Birdies had already been struck off (with their consent) pursuant to issuance of a notice by the ROC under Section 248 as it was not carrying on any business for two financial years – however, the same was held to be different from the disqualification under Section 164(2)(a), on account of the fact that the disqualification affects ability of the director to be on the boards of other companies (which may otherwise be compliant with the law).

Critical Analysis

This ratio of the Madras High Court is significant. The Act does not require any personal hearing to be given to any director who stands disqualified. In fact, a reading of the provision indicates that the disqualification is by operation of law and thus, automatic. All that the ROC does is publish a list of those directors who stand disqualified *inter alia* on account of defaults/omissions on the part of the companies with which they are associated. In the present case, the Court held that the ROC had wrongly interpreted these provisions and declared the directors of Birdies (including the Petitioner) disqualified. Hence, the petitioner was clearly entitled on the facts of the case (even apart from the other legal arguments available to it) to have such disqualification set aside. But, the Madras High Court, by also holding that the ROC ought to have given an opportunity of personal hearing to the directors before disqualifying them, appears to have created a statutory right in favour of directors, who otherwise stand disqualified under Section 164(2)(a), to contest their potential disqualification; and in the meantime, keep their disqualification at bay. Moreover, this ruling in a sense widens the ROC's powers/functions with regards to disqualification of directors, which otherwise was limited to publishing the list of directors who stand disqualified under the aforesaid provisions. By requiring the ROC to hold personal hearings prior to disqualification, quasi-judicial functions have now been conferred upon the ROC on this issue of director disqualification, although the statute does not provide so.

As a result of the aforesaid decision of the Madras High Court, ROCs subject to the jurisdiction of the Madras High Court are bound to follow the requirement of a personal hearing for the concerned directors before disqualifying them.

An interesting question that emerges is whether the requirement to give a personal hearing that has been read into Section 164(2) of the Act by the Madras High Court, would also be applicable to ROCs not subject to the territorial jurisdiction of the Madras High Court.

In the matter of *CIT vs. Godavari Saraf (1978 113 ITR 589 Bom.)*, it was held *"It should not be overlooked that the Income-Tax Act is an All India statute and if an Income Tax Tribunal in Madras, in view of the decision of the Madras High Court, has to proceed on the footing that section 140A(3) was non-existent, the order of penalty cannot be imposed by the authority under the Act. Until a contrary decision is given by any other competent High Court which is binding on a Tribunal in the State of Bombay, it has to proceed on the footing that the law declared by the High Court, though of another State, is the final law of the land....That section was already declared ultra vires by a competent High Court in the country and an authority like an Income-Tax Tribunal acting anywhere in the country has to respect the law laid down by the High Court, though of a different State, so long as there is no contrary decision of any other High Court on that question".*

The Supreme Court, in its judgment in the matter of *Kusum Ingots & Alloys Ltd. vs. Union* *of India (2004) 6 SCC 254* has held that "*An order passed on a writ petition questioning the Constitutionality of a Parliamentary Act, whether interim or final keeping in view the provisions contained in clause (2) of Article 226 of the Constitution of India, will have effect throughout the territory of India subject of course to the applicability of the Act.*"

It, therefore, appears that when it comes to a Central Statute, any decision of a High Court, which either strikes down any statutory provision therein, or interprets such statutory provision, would be binding across India. This is from the perspective of having uniformity and consistency in laws across India. In view of the aforesaid position in law, it does appear that ROCs outside Tamil Nadu will also be bound by this decision of the Madras High Court and be required to give a personal hearing to potentially disqualified directors.

The purpose of Section 274(1)(g)/ Section 164(2)(a), was/is to target those directors whose companies have been persistently defaulting for any continuous period of three financial years in filing their returns, etc. such that these directors when faced with a potential disqualification, would cause the concerned companies to become compliant. Thus, directors were indirectly cast with the onus of ensuring the company's compliance with the law, the expectation being that consequently, directors would remain diligent *vis-a-vis* the acts and omissions of the company.

No court had in the past read the requirement of a personal hearing into Section 274(1)(g) of the 1956 Act (*pari materia* with Section 164(2) of the Act). Even recently, when amendments were proposed *inter alia* to Sections 164 and 167 (which deals with the vacation of office by a director), the Companies Law Committee, under the Ministry of Corporate Affairs, Government of India, did not recommend that directors who were liable for disqualification, must be given a personal hearing.

Now, if in line with the decision of the Madras High Court, a personal hearing has to be given to the concerned directors before holding them to be disqualified, in the meantime, these directors would continue to be able to be appointed and reappointed in companies. Since, orders passed after such personal hearing would be capable of being challenged in courts, even in cases, where a director has absolutely no defence or argument, the director would be able to stave off the disqualification for some time.

While it is difficult not to empathise with directors who face automatic and personal disqualification (which affects their directorship in other companies also) on account of defaults by companies with which they are associated (especially non-executive/independent directors), the construct of Section 164(2) does not give any ability to such directors to ward off such disqualification by arguing extenuating circumstances. That being the case, except in a few cases, it is not clear if a director would have a substantive defence or argument to advance. Hence, the right of personal hearing would only enable such directors to continue to be eligible, until their disqualification is decided; which arguably would run counter to the objective of this provision. The decision of the Madras High Court could also potentially open the floodgates to new arguments such as that a distinction should be drawn between independent directors, executive directors and non-executive directors, and that the provisions of Section 164(2)(a) should not be applied to non-executive directors, since they are not in conduct of the operations and management of the company.

Having said the above, it does not appear that this decision of the Madras High Court has been challenged in the Supreme Court. Hence, until there is a contrary decision by another High Court or by the Supreme Court, the right of the personal hearing will have to be deemed to be inherent in Section 164(2) of the Act.

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CA Dinesh Tejwani

TECHnovation

Regulatory Compliance Management

In World Bank's Ease of Doing Business Index India ranks 100th among 190 countries. This rank is a jump of 30 points in the year 2017 as prior to that, India's rank was 130.

In another interesting report by TMF group The Compliance Complexity Index 2018 India is placed at rank 15 among 84 countries. According to this report, the most complex jurisdictions are UAE, Qatar, China, Argentina and Malaysia, while the easiest jurisdictions are Ireland, Denmark, Curacao, Honduras and Nicaragua

India is also at rank 5 in complexity in the Asia Pacific region.

From the above, it is clear that it is difficult to start a business in India and continue running it and indeed, even wind an entity up, with its complex and vast array of laws.

Risks of Non-Compliance

Regulatory compliance is critical for any business. Good compliance track of a business has several benefits: efficiency cost savings, trust and brand loyalty and competitiveness.

On the other hand risk of non-compliance are enormous: from pecuniary fines, civil and criminal liability to denial of the license to continue business. Not to forget the reputational damage that comes with the negative publicity.

It will be interesting to see some figures in this respect.

Receipt Budget of 2018-19 by the Central Government shows the following figures

Amount in Crores (₹)	**Penalties**	**Interest**
Corporation Tax	199.98	2281.51
Income Tax	310.74	3087.37

According to the MCA Annual report for the year 2016-17

No of prosecutions filed during the year	4,522
Pending prosecution at the end of year	48,988

Recently the Registrar of Companies has sent notices of deregistration to 2.25 lakh companies who failed to file their annual returns for the last 2 years.

The Income tax department in recent times has been issuing prosecution notices. According to a newspaper report around 1 lakh, such notices have been issued. Some of the notices pertain to even default in depositing small TDS amounts.

A few examples of this are

Cheating and forgery case against builder Niranjan Hiranandani for non-payment of provident fund dues. The 10-year-old case pertains to PF liability of contractors employed by the firm.

Very recently Bandhan Bank was barred by RBI from opening new branches without prior approval, the salary of its CEO was frozen, for its failure to comply with shareholding rules.

Large Organisations and SMEs

While large companies have the resources and systems to manage a vast array of compliance, it is the SME sector which has to bear huge cost of non-compliance.

The Ministry of Micro, Small & Medium Enterprises too in a report recognized the fact that the compliance burden on MSME needs to be reduced.

Most MSME businesses are proprietor or partnerships, where the compliance burden falls upon the owners. Such businesses typically depend on the advice of chartered accountants and tax advisors.

It is a common practice for CAs to send a reminder of monthly compliance to their clients.

Even large organisations who have not automated compliance, typically follow a system where each unit/function is made responsible for its own compliances. The central compliance team works on advising these units and compiling regular compliance reports to report to the Board.

Start-Ups

Start-Ups in India have another set of challenges. Most of the startups are being set up and run by youngsters in the 25-35 age group and they come from the technology background. They generally rely on a professional to take complete responsibility of compliance. Yet a survey of Tax Mantra in 2016 brought out some alarming facts

- Every 2nd Startup gets Income Tax Notice for tax demands or for non-compliance
- 3 out of 7 Startups find a place on the defaulter list of Registrar of Companies due to non-compliance
- 2 out of 4 Startups incur unnecessary pay-out by way of interests and penalties.

To address the challenges of this set of entrepreneurs, few startups have started offering standard packages for typical compliances. Some of these are Legalwiz.in, Wazzeer.com, http://thestartupbox.in etc.

Complexity

Every business has to comply with Central, State and local laws. This poses a challenge for a business having multiple units across various States. According to a CII Survey in 2013 on an average, a manufacturing company has to comply with 70 laws and 100 returns in a year.

Further, the compliances can vary in nature

Calendar based: There are due date based compliances. Example: Filing Income tax Return, TDS Return, GST Returns.

One Time: These are required only once. Example: Registration on GST Portal. Formation of a business entity.

Ongoing: These compliances have to be followed on regular basis in a running business. Example: maintenance of books of account, minimum wages, holding board meetings.

Event-Based: These compliances get triggered on the occurrence of an event such as change of name, change of place of business.

Challenges of Awareness

One of the biggest problems is being aware of compliance to be undertaken and the due date(s) thereof. This is especially true of SME businesses. At times they are not aware of the applicability or otherwise of a certain compliance. Frequent changes in law and rules further complicate the situation.

For a newly introduced GST, the number of Notifications, Circulars and Orders issued under CGST and IGST during July to June is an astounding 246 Notifications, 78 Circulars and 14 Orders!

While there is sufficient dissemination of Central and State level laws, the same is not the case with local laws.

Challenges of Tracking and Managing

Even if an organisation is sufficiently aware of the compliance it has to undertake, managing it becomes difficult in the absence of automation. I recently came across a large multi-location organisation having customer-facing stores numbering 300 across various cities. For local level compliance, the store manager was given a check-list, which she/he was supposed to complete and email to compliance department on monthly basis. Tracking, collating and making sense of 300 excel sheet on monthly basis, was proving ineffective.

How automation helps

While no amount of automation can replace human intelligence required to manage compliances, it does help in several ways.

Central Repository	Responsibility	Tracking and DashBoard
A single repository for all Central, State and Local level compliances. Regularly updated for amendments	Applicability to each unit and the responsible person clearly defined. Compliance completion document as the source of truth.	Dashboard for Completed, Due and Not Done. Alerts and Reminders. Escalation. Financial loss due to non-compliance

Central Repository

A single repository of all applicable laws which is always updated is the first step for any good automation to work. There may be cases where the software provider takes responsibility of updating the changes in the law, else the business has to have its own system of updating it.

Example: Ricago Compliance Management System is equipped with a robust compliance library that houses 900+ Legislations and 23,000+ Compliance line items covering all sectors and business verticals.

Responsibility

Once all compliances are at one place, each business unit/department and a user has to be assigned specific sets of compliances. An escalation matrix can also be defined so that non-compliances can be tracked and handled in time.

Once the compliance procedure is completed, there is a provision to upload the substantiating document so that audit is possible. For example after payment of tax, the challan receipt can be uploaded as proof.

DashBoard

For the compliance department and manager, a single view of all compliances and various stages are available in a dashboard. At any given time, Forthcoming, Due, In Process, Completed and Not Competed can be viewed in real time. Senior management is in complete control of the situation.

Tracking

There are various tools available to easily track compliances. Compliance calendar, alerts and emails as a reminder, workflow to complete it and auto e-mail for escalation are some of such tools.

Automation Software

There are several solutions available in the market. Most of the solutions are SaaS-based. Some of the names are Lexplosion, Proind, Compfie, Ricago, Volody.

Each software provides a different set of functionality and features. Few salient features worth looking at are listed below:

- Suggest compliance requirement based on entity type and location
- Triggering follow up process for non-compliances and escalation
- Automatic notification of any update in regulatory change
- Track financial impact of non-compliances
- Event-based compliance to list pre-event, during-event and post-event compliances break-up. Example: Holding AGM.
- Listing dependent compliances
- Document library with an easy search facility to track all compliance related documents.
- Generate Compliance Certificate for internal or external use
- Use data analytics to mitigate risk
- Track compliances function wise, unit wise or compliance nature-wise
- Provide Assurance Reports to management/Board of Directors on Compliance

Conclusion

With growing complexity and number of compliance ever increasings, the need of the hour is to move away from excel based or manual tracking to automated tools to effectively monitor and manage compliance requirements in an era of increasing complexity.

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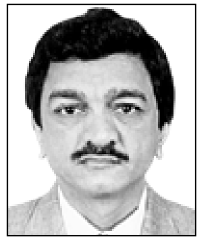


B. V. Jhaveri, *Advocate*

DIRECT TAXES

Supreme Court

Section 194C read with section 204(iii) will come into operation only on payment made by the Contractor

[2018] 95 Taxman 142 (SC) – Commissioner of Income-tax, Jaipur vs. Daulat Enterprises

1. The assessee firm had undertaken the contract of handling and transporting gypsum from the mines to the factory of various companies like Benani Cement, ACC Cement, Mangalam Cement, etc. For rendering these services, the assessee firm had raised its invoices which would include the payment made to truck owners for using their trucks for transportation. On payment being made to the truck owners, the assessee firm had deducted tax at source and paid the same to the State Exchequer. In the case of M/s. Mangalam Cement, the freight to the truck owners was directly paid by M/s. Mangalam Cement and therefore, from the invoice of the assessee firm the said payment for transportation to truck owners was deducted by M/s. Mangalam Cement and the balance amount for handling the goods was paid to the assessee firm.

2. As the assessee firm had passed the entries and transferred the transportation cost paid to the truck owners by M/s. Mangalam Cement from its invoice value to the account of M/s. Mangalam Cement, who had thereafter paid transportation charges to the truck owners directly. This amount was disallowed by the AO invoking section 40(a)(ia) on the ground that the assessee firm had failed to deduct tax at source on the payment made for transportation of goods to M/s. Mangalam Cement. The case of the assessee firm was that the freight was directly paid by M/s. Mangalam Cement and the payment of the invoice of the assessee was made after deduction of freight paid by M/s. Mangalam Cement and hence the balance amount was received by the assessee firm as handling charges. The assessee had only made book entries with regard to the freight paid by M/s. Mangalam Cement directly to the truck owners in the account of M/s. Mangalam Cement in respect of the bills raised by the assessee firm. Thus the assessee firm had not paid freight and therefore, section 194C had no application.

3. The Tribunal allowed the appeal of the assessee firm and held that when payment of freight was made by M/s. Mangalam Cement directly to the truck owners, it was not possible for the assessee to make deduction and payment of taxes thereupon. The assessee had only received handling charges and all acts and obligations were carried out by M/s. Mangalam Cement. As such neither there was any obligation on the part of the assessee nor was it

possible for the assessee to make deduction of taxes thereupon. The Tribunal, therefore, did not find justification in the observation of the CIT(A) that M/s. Mangalam Cement was making payment to truck owners only on behalf of the assessee and the assessee was a contractor and truck owners were sub-contractors. The appeal of the Revenue was dismissed by the Rajasthan High Court wherein their Lordships held that as rightly contended by the counsel for Respondent, section 194C r.w.s. 204(iii) come into operation only on payment made by the assessee and as rightly discussed, since payment was not made by the assessee there was no default on the part of the assessee. Accordingly, the appeal was dismissed.

4. The SLP filed by the Department was dismissed as their Lordships did not find any ground to interfere with the judgment of the High Court.

Noida is a corporation under the Act and hence covered by Notification dated 22nd October, 1970 issued u/s.194A(3)(iii)(f) of the Act.

[2018] 95 taxmann.com 80 (SC) – Supreme Court of India– New Okhla Industrial Development Authority vs. Commissioner of Income-tax

1. New Okhla Industrial Development Authority (NOIDA) has been constituted by Notification dated 17th April, 1976 issued u/s. 3 of the U.P. Industrial Area Development Act, 1976. Canara Bank made payment of interest on fixed deposits in financial year relevant to A.Y. 2006-07. From this, Canara Bank had not deducted tax at source u/s.194A of the Act. The AO issued notices to Canara Bank as well as to NOIDA to show cause for non-deduction of tax at source. A Writ Petition filed by NOIDA challenging the notice issued to it as well as to the Bank was dismissed by the High Court on 28th February, 2011 holding that NOIDA is not a local authority within the meaning of section 10(20) of the Act and its income is not exempt from tax. The AO thereafter passed the order u/s. 201(1) / 201(1A) r.w.s. 194 of the Act and held that Canara Bank is an assessee in default.

2. In the appeal before the Commissioner (Appeals), the bank relied on Notification dated 22nd October, 1970 issued u/s.194A(3)(iii)(f) of the Act. The said appeal was allowed by the Commissioner (Appeals). The Tribunal also dismissed the appeal of the Revenue and therefore, an appeal u/s. 260A of the Act was filed with the High Court. Dismissing the appeal of the Revenue, the High Court held that there is no doubt that NOIDA is a Corporation established by a State Act and therefore, it is entitled to exemption to payment of tax at source u/s. 194A(1) of the Act. The Court also considered the decision wherein the Court had held that NOIDA is not a local authority but the said decision did not deal with the issue as to whether NOIDA is a Corporation established by the State Act.

3. The Supreme Court held that what is contended before the Court is that NOIDA having not been established by a Central, State or Provincial Act, is not covered by Notification dated 22nd October, 1970 and hence not eligible for the benefit.

4. The Supreme Court observed that in *Dalco Engineering Pvt. Ltd. vs. Satish Prabhakar Padhye & Ors. [(2010) 4 SCC 378)]* it was held that establishment of various financial corporations under the State Financial Corporation Act, 1951 is establishment of a Corporation by an Act or under an Act. The ratio of the aforesaid decision squarely applies and therefore, NOIDA established by 1976 Act is clearly covered by the Notification dated 22nd October, 1970. In the result, the appeal of the Revenue was dismissed.

At time of initiation of proceedings in the year 2008 for cancellation of registration u/s. 12AA(3), the Commissioner did not have the powers and hence impugned order passed by

him cancelling registration was set aside; SLP granted

[2018] 96 taxmann.com 257 (SC) – Principal Commissioner of Income-tax, Kolkata vs. JIS Foundation

1. The assessee its Foundation was granted registration with effect from 1st September, 1999 for running educational institution. Subsequently, the Commissioner noted that the assessee was charging capitation fees from students in the garb of donation. He, therefore, opined that the activities of the Trust were not genuine and were not being carried out in accordance with the objects of the Trust and initiated proceedings for cancellation of the registration and ultimately cancelled the registration on 31st December, 2008.

2. The High Court held that provision empowering cancellation of registration of the Trust granted under section 12A was brought in by sub-section (3) of section 12AA by the Finance Act, 2010, with effect from 1st June, 2010, and therefore, at time of initiation of proceedings for cancellation of registration in the year 2008, the Commissioner did not have such a power in terms of section 12AA(3) and consequently, impugned order was set aside.

3. The Supreme Court is pleased to admit the SLP against the said order of the High Court of Kolkata.

SLP of the Revenue is dismissed in respect of deduction u/s. 80-IB(10) on the issue that local authorities can approve a project as 'Housing Project' along with commercial user to the extent permitted under the DC Rules/ Regulations framed by respective local authorities

[2018] 96 taxmann.com 273 (SC) – Commissioner of Income-tax vs. Suyog Shivalaya, July 20, 2018

1. Dismissing the SLP the Supreme Court has approved the decision of the Bombay High Court in the case of *CIT vs. Makwana Brothers & Co. (HWP) (86 taxmann.com 278).* The Bombay High Court followed its own decision in the case of *CIT vs. Brahma Associates (333 ITR 289)* wherein the Division Bench held that expression 'Housing Project' is not defined under the Act. However, section80-IB(10) refers to Housing Projects which are approved by local authorities. Therefore, for the purpose of section 80-IB(10), which project should be treated as 'Housing Project' is left to the local authorities.

2. Development of every region is regulated by the concerned local authorities in accordance with the Development Control Rules/ Regulations framed by the local authorities which is dependent upon the needs of that region. Therefore, which project would qualify to be called a 'Housing Project' has to be gathered from the Rules/Regulations framed by the local authority. The Court, therefore, held that whether the Housing Project is of only and purely residential units and not commercial units or no commercial user, is contemplated by it, was an issue or question not open for the Income-tax Authorities to decide particularly when the projects have been approved as Housing Projects by the Planning Authority/ local authority. In this respect, the Court referred to and relied upon the insertion in section 80-IB(10) with effect from 1st April, 2005. The Division Bench held that the Development Control Regulations which prevail for cities and planning authorities in each case would have to be understood for interpretation of the expression 'Housing Project' as also the nature of the users envisaged and permitted therein in a Housing Project.

3. Thus the Division Bench of the Bombay High Court had followed its earlier decision of the Division Bench in *CIT vs. Vandana Properties (353 ITR 36).*



Paras S. Savla, Jitendra Singh, Nishit Gandhi, *Advocates*

DIRECT TAXES

High Court

1. Section 41(1) - Remission or cessation of trading liability - Section 41(1) of the Income-tax Act, 1961 – due to continuous losses, payments and debts due including those due to financial institutions are not paid – Since likelihood of payment was remote as business has stopped AO made addition u/s. 41. Held that circumstances would not by itself denote and mean cessation or remission of liability – addition deleted. [A.Y. 2005-06]

PCIT vs. New World Synthetics Ltd. [2018] 97 taxmann.com 399 (Delhi)

The assessee company had an outstanding liability of ₹ 2,61,72,160/- due and payable to M/s. P.T. Polysindo, Jakarta, Indonesia since 31-3-2003. This liability was shown and acknowledged in the balance sheet and the accounts prepared by the assessee for year ending 31-3-2006. These were filed with Registrar of Companies and Income tax department. While the liability to pay was not disputed the Assessing officer insisted and claimed that there was cessation of liability as the amount had remained outstanding and unpaid since 31-3-2003 till 31-3-2006 and the debt due to P.T. Polysindo had become barred by limitation. Further there was no likelihood of making payment as assessee had incurred huge losses and stopped business operations during the period relevant to AY 2000-01. The High Court observed that the word "cessation" in common parlance and in context in which it is used in section 41(1) connotes that debt has become extinct, has come to an end or it has been forfeited. "Remission" implies cancellation or extinguishment of all or part of financial obligation on part of the creditor. While the explanation also states to include remission and cessation by unilateral act, the Court observed that in the present case there was no unilateral act by the assessee as it had not written off the outstanding amount payable to P.T. Polysindo. The Court held that delay or non-payment, even when the AO is of the opinion that likelihood of payment was remote as business has stopped, would by itself not denote and mean cessation or remission of liability. In the winding up or bankruptcy proceedings, payments are made, mostly partly on sale of assets. Further debt or liability may subsist notwithstanding its recovery was barred by limitation for the law of limitation merely bars the creditor from invoking legal remedy. Expiry of period of limitation as prescribed in limitation act does not extinguish the debt but only prevents the creditor from enforcing the debt. The Court held that there was patent flaw when the department ignored and overlooked admission of liability to pay as the assessee had acknowledged the debt payable. Debt acknowledged and admitted in the balance sheet and accounts filed with the Registrar of Companies is an acknowledgement within the meaning of Section 18 of Limitation Act. Hon'ble High Court thus dismissed the appeal of the department holding that there was no remission or cessation of liability.

2. Credit for tax deducted u/s section 199 of the Income Tax Act, 1961 – TDS deducted from the salary of the assessee – employer failed to pay TDS to government treasury – department cannot recover the TDS amount from the assessee and credit for such TDS is to be allowed

Devarsh Pravinbhai Patel vs. Asstt. CIT [Special Civil Application Nos. 12965 and 12966 of 2018 dated 24-9-2018 (Gujarat High Court)]

The assessee before the Hon'ble Gujarat High Court was an individual. The assessee during the relevant period 2012-13 was employed as a pilot of Kingfisher Airlines. During the relevant period the employer had deducted tax at source on salary payments made to the assessee. Such TDS came to ₹ 2,68,498/-. However the employer did not deposit such tax with the Government. The assessee claimed credit of such TDS in his liability to pay tax to the Government. The Department however objected to this and raised equivalent tax demand with interest. Towards such recoveries the Department in fact adjusted a refund of ₹ 47,140/- from the assessee for the assessment year 2013-14. The assessee being aggrieved filed a Special Civil Application before the Hon'ble Gujarat High Court. The Court allowed the application of the assessee by observing that the Department cannot deny the benefit of tax deducted at source by the employer of the assessee during the relevant financial years. It held that credit of such tax should be given to the assessee for the respective years and if there has been any recovery or adjustment out of the refunds of the later years, the same should be returned to the assessee with statutory interest.

Note: *Court relied on Sumit Devendra Rajani vs. ACIT (2014) 49 taxmann.com 31 (Guj.) and on ACIT vs. Om Prakash Gattani (2000) 242 ITR 638 (Bom.)*

3. Business income u/s. 28 – Securitisation of lease rent receivable – Gains i.e., difference rent receivable and rent payable, credit to P & L account – Not capital receipt and taxable as revenue receipt – Question of matching concept never argued before lower authorities cannot be taken at this stage

L&T Finance Ltd. vs. DCIT, Bombay High Court, ITA No. 256/2016 & 267/2016, order dt. 17-9-2018

The assessee was a company registered under the Companies Act and is registered as a non-banking Finance Company with the Reserve Bank of India *inter alia* engaged in the business of leasing, hire purchase and other financial activities. For Assessment Year 2002-03 the assessee securitised rent receivables from April, 2002 to March, 2004. The total amount receivable during the aforesaid period was ₹ 10.39 crore which was securitized at the rate of 10.50% for the net present value at "₹ 9.33 crores. This amount of ₹ 9.33 crores was received by the assessee in AY 2002-03 but which related to the Assessment years 2003-04 and 2004-05. This amount of ₹ 9.33 crores received on securitisation, was adjusted against the outstanding rent receivable of ₹ 7.64 crores in the books of account of the assessee and the balance amount of ₹ 1.69 crore was recognized as a profit on securitisation of lease receivables in the profit and loss account. The assessee, accordingly, filed its return of income for the AY 2002-03 on 29th October, 2002. After scrutinising the return filed by the assessee, the A.O. *vide* his assessment order added the amount of ₹ 1.69 crore as an income on the ground that assessee itself had credited this amount to its profit and loss account. He held so, taking into consideration that the gain related to the business of the assessee and also arose in the normal course of business carried on by the assessee. The AO also relied upon a decision of the Supreme Court in the case of *CIT vs. T.V. Sunderam Iyengar & Sons Ltd. (222 ITR 344)* to hold that this amount of ₹ 1.69 crore was a revenue receipt and hence was taxable in the hands of the assessee. The CIT(A) and Tribunal confirmed the addition. On further appeal, the High Court observed that the CIT(A) had rejected the argument of the assessee that the gain represented only a notional income by holding that this contention was contrary to the effect given by the assessee itself in the profit and loss account, where the said amount was credited. The CIT(A) gave a categorical finding that the approach of the assessee was contradictory. By entering into the securitisation of lease receivables with Development Credit Bank availed of finance for its business purpose. As a result, there was a gain to the assessee representing the difference between the amount financed and the amount shown as outstanding in the Loans and Advances account. The assessee had deferred such gains over a period of two years and credited the sum of ₹ 1.69 crore to the Profit and Loss account for the year under consideration (AY 2002-03). Before the Court the assessee for the first time argued that it was entitled in law to spread over this income of ₹ 1.69 crore over a period from years 2002 to 2004 on the basis of the "Matching Concept". It was submitted that notwithstanding that the entire amount was received in the current year, this spread over could be allowed and should be allowed otherwise it would lead to a distorted picture of the profit of a particular year. If the "matching concept" was not applied, then the profit would get wholly distorted which was not in the interest either of the Revenue or of the assessee. Assessee further relied upon a decision of this Court in the case of *Taparia Tools Ltd. vs. Joint C.I.T. reported in (2003) 260 ITR 102 (Bom).* However the Court held that whether the "matching concept" ought to have been applied in the present case is a mixed question of fact and law, the foundation of which has never been laid by the assessee before the authorities below. If the factual foundation for this argument has not been laid before the authorities below, no substantial question of law can arise therefrom. As far as the decision in the case of Taparia Tools Ltd. (supra) was concerned, the same did not deal with applying the "matching concept" to "income" but rather to "expenditure". Whether the same would apply to the income also, is a wholly different matter. Further decision in case of Taparia Tools Ltd. was set aside by Supreme Court reported in (2015) 372 ITR 605 (SC). The Supreme Court, while setting aside, *inter alia* held that there is no concept of deferred revenue expenditure in the I.T. Act, 1961 except under specified sections, i.e., where amortisation is specifically provided for such as in section 35D of the Act. The Supreme Court also held that, normally, the ordinary rule is that revenue expenditure incurred in a particular year is to be allowed in that year. Thus, if the assessee claims the expenditure in that year, the Department cannot deny it. However, in a case where the assessee himself wants to spread the expenditure over a period of ensuing years, it can be allowed only if the principle of the "matching concept" is satisfied, which up to now has been restricted only to cases of debentures. Thus no reliance can be placed on the said judgment. The Court dismissed the appeal stating that it did not give rise to any substantial question of law.

4. Principles of natural justice – Representative for the assessee withdrew his power of attorney – Thereafter fresh notice was issued to the parties to appear – Without ascertaining whether that notice was duly served on the assessee the Tribunal should not have proceeded further

Lalitnirman Business Development Pvt. Ltd. vs ITO, Bombay High Court, ITA No. 17/2016, order dt.19-9-2018

The Appeal was filed by the department against the Tribunal order. Further cross objection were filed by the assessee and both were heard together. The Court observed that the Tribunal had adjourned the matter at the request of the counsel of the assessee, who on 10-9-2014 withdrew his power of attorney *vide* letter dated 12-6-2014. Thereafter, the notice was issued by Tribunal to the parties to appear on 1-1-2015. None appeared on behalf of the assessee on 1-1-2015 and the learned Departmental Representative for the Revenue was directed to serve the notice for hearing on 20-4-2015. The Tribunal stated that the said notice was served upon the assessee, however, none appeared on behalf of the assessee on the appointed date of hearing nor any application was moved for adjournment and hence Tribunal proceeded to decide the appeal after hearing the learned Departmental Representative of the Revenue. Before the High Court, both parties informed the Bench the assessee had preferred an application seeking rectification of the mistake and, in any event, recall of the order for the simple reason that the impugned order is passed in its absence. Once the order was passed in its absence, then, the expectation of the assessee was that by imposing reasonable conditions, it can be furnished and afforded a fresh opportunity to argue the matter on merits. That rectification application is still pending and it remains undecided. The High Court was of the view that keeping the appeals pending would not subserve the interest of justice and eventually, if a remand is necessitated, then, that would have to be ordered, but after losing precious judicial time. The Court observed that once the representative for the assessee withdrew his power of attorney, a notice was issued to the parties to appear, but without ascertaining whether that notice was duly served on the assessee, there is a proof of such service and the assessee has avoided intentionally and deliberately to attend the case or hearing, the Tribunal should not have proceeded further. Such an approach results in miscarriage of justice as well. Hence the Court quashed and set aside the impugned order and directed that the appeals be heard afresh by the Tribunal. At this fresh hearing, it shall pass a reasoned order consequent upon the submissions of both sides being heard, the contents of the documents and record being noted. The fresh order shall be passed, uninfluenced by any conclusions in the earlier order which is set aside. It also directed the Tribunal that it now need not pass any orders on the application for rectification.

5. Cash credit u/s. 68 – Unsecured loans/advances – Notice issued u/s. 133(6) – No reply or notice unserved – Assessee gave PAN details, business address, bank statements, company statements maintained with ROC – Not sufficient – Assessee should also explain surrounding circumstances – Addition confirmed

Pratham Telecom India Pvt. Ltd. vs. DCIT, Bombay High Court, ITA No. 316/2016, order dt.17-9-2018

For Assessment Year 2009-10, assessee company filed a return showing total loss of ₹ 77,01,919/. The six entities from whom the assessee borrowed sums without security were selected for scrutiny. Though the Assessing Officer issued notices to these entities under Section 133(6) he found there was no reply, or the notices returned unserved. Only one party confirmed the loan of ₹ 5,00,000/-. It is in these circumstances, the Assessing Officer doubted the transactions and made addition of remaining five parties. He added back ₹ 1,45,00,000/- to the total income under Section 68 of the I.T. Act. The assessment order was confirmed by CIT(A) and also the Tribunal. On further appeal, the High Court observed that the Tribunal has extensively referred to the entities and the details in relation thereto provided by the assessee. The burden on the assessee has not been discharged by it. The assessee cannot simply provide some details such as Permanent Account Number, business address, the account which was maintained and a Bank Statement, or a Company's Master Data maintained by the Registrar of Companies. The assessee is obliged to explain the surrounding circumstances and the backdrop in which the transactions took place. In the case of five entities, the Tribunal referred to these details and concluded that the assessee has failed to discharge the burden. More so, when three out of the five assessees could not be served. The rest did not either give a reply, or gave a reply which was not at all satisfactory. The High Court observed that the concurrent findings of fact, therefore, are based on appreciation and appraisal of the evidence before the authorities and there are no errors of law apparent on the face of the record, particularly in understanding the ambit and scope of Section 68 of the I.T. Act. Thus the assessees appeal was dismissed.

Neelam Jadhav, Neha Paranjpe & Tanmay Phadke, *Advocates*

DIRECT TAXES
Tribunal

Unreported Decisions

1. Business Expenditure – Section 37(1) of the Act – Insurance premium paid for employees' family members should be allowed u/s. 37(1) of the Act, if the same are paid in terms of employment rules framed by assessee Company.

Loesche India (P.) Ltd. vs. ACIT, New Delhi (ITA 295/DEL/2016)[Assessment Year: 2010-11] order dated 1-8-2018, [2018] 96 taxmann.com 483 (Delhi - Trib.)

Facts

The assessee is a Private Limited Company. The assessment year under consideration is A.Y. 2010-11. The return of income was filed on 30-9-2010 declaring total income at ₹ 19,12,54,863/-. During the impugned assessment year, the assessee claimed expenses on account of medical insurance amounting to ₹ 15,48,654/- incurred for the family members of employees u/s. 37(1) of the Act. During the course of assessment proceedings, the learned AO observed that the assessee had adopted an inequitable and unreasonable system by bearing the medical insurance expenses of the relatives of managerial persons and their distant family members. Further, it was observed that the employees had not offered the said amount as perquisites u/s. 17(2)(iv) of the Act. Thus, the learned AO was of the view that these expenses were not the business expenses qualifying for a deduction u/s. 37(1) of the Act. The learned AO, therefore, made a disallowance of the said medical insurance expenses amounting to ₹ 15,48,654/- u/s. 37(1) of the Act. On appeal, the learned CIT(A) confirmed the disallowance made by the learned AO Being aggrieved, the assessee preferred an appeal before Hon'ble ITAT. After considering the submissions of both the sides, Hon'ble ITAT observed as under:

Held

Hon'ble ITAT held that the assessee had paid the insurance premiums of the employees' family members as per the terms of employment Rules framed by the assessee Company. Therefore, it is incorrect to say that the said expenses were not incurred wholly and exclusively for the purpose of business as per Section 37(1) of the Act. Further Hon'ble ITAT observed that the authorities below could not bring any evidence on record to substantiate that the payments so made by the assessee had no nexus with the business of the assessee. It further held that the contention of the authorities below that the said amounts were required to be considered and taxed as perquisites in the hands of the said employees is not correct in the light of provisos (iii) and (iv) appended to section 17(2) of the Act. On the aforesaid observations, Hon'ble ITAT allowed the said expenses u/s. 37 of the Act and held in favour of the assessee.

2. Capital Gains – Section 45 r.w.s. 50 of the Act – the compensation received on acquisition of land and building is to be bifurcated for the purpose of the computation of Capital Gains under Section 50 of the Act

Het Ram Sharma vs. ITO (ITA 482 & 483/CHD/2018) [Assessment Year 2008-09], Order dated 23-7-2018, (2018) 97 taxmann.com 75 (Chandigarh – Trib.)

Facts

The assessee is an individual and the assessment year under consideration is 2008-09. During the said assessment year, the assessee received a compensation of ₹ 30.11 lakh on transfer of the properties by way of acquisition of the same by the Land Revenue Officer. However, no Capital Gains were offered in the return of income. Thereafter, the reassessment proceedings were initiated by issuance of a notice u/s. 148 of the Act to assess the said Capital Gains not disclosed by the assessee in his return of income. During the course reassessment proceedings, the learned AO observed that one of the properties transferred was a hotel building /dhaba which was utilised for commercial purposes. As per the contention of the learned A.O, the gains from the said property were short term in nature in the light of section 45 r.w.s 50 of the Act. Therefore, the learned A.O., after reducing WDV of the hotel building /dhaba (as on 1-4-2007 i.e., WDV as on the first day of the previous year) from the compensation received, computed the STCG at ₹ 11.12 lakh and added the same to the total income of the assessee. Aggrieved by the same, the Assessee preferred an appeal before the learned CIT(A) but did not find any success on the issue under consideration. Thereafter, an appeal was preferred before Hon'ble ITAT. During the course of hearing, it was mentioned before Hon'ble ITAT that the consideration was received not only for the building but also for the land which was a non-depreciable asset. Further it was submitted that since the consideration was received for depreciable as well as non-depreciable asset, section 50 of the Act did not have any applicability since the same is applicable only in the case of transfer of a depreciable asset alone. On the contrary, the learned DR opposed the submissions of the learned AR of the assessee. After hearing both the parties, Hon'ble ITAT observed as under:

Held:

Hon'ble ITAT observed that the only issue under consideration is whether the capital gains earned on transfer of the said asset (i.e., hotel building/dhaba) by way of compulsory acquisition were in nature of STCG as per section 50 of the Act or otherwise LTCG. Hon'ble ITAT observed that the assets for which the assessee received the compensation constituted both land as well as building and in the light of the said facts, it held that the said compensation has to be bifurcated between the land and building. Hon'ble ITAT perused the relevant provisions and held that the capital gains on transfer of the building which was a depreciable asset are required to be treated as short term in nature whereas the capital gains on transfer of the land under consideration which was not a depreciable asset are required to be treated as long term in nature. After coming to the said conclusion on the legal issue, Hon'ble ITAT restored the matter back to the file of the learned AO to redetermine the same in the light of the abovementioned observations. Accordingly, the appeal of the assessee was allowed for the statistical purposes.

3. Exemption – Section 54 of the Act – No exemption u/s. 54 shall be denied considering the date of registration of conveyance deed as the date of transfer – the date of agreement to sell is to be taken as the date of transfer for allowing the exemption under section 54 of the Act

Gautam Jhunjhunwala vs. ITO – 25(4), Kolkata (ITA 1356/Kol/2017) [Assessment Year: 2012-13], Order dated 7-9-2018

Facts

The assessee is an individual. The assessment year under consideration is 2012-13. During the said assessment year, the assessee sold a flat for total consideration of ₹ 30 lakh *vide* agreement to sale executed on 16-9-2011. Out of total consideration of ₹ 30 lakh, the assessee received a sum of ₹ 1 lakh by way of an earnest money at the time of execution of the said agreement to sale. Thereafter, a registered Deed of Conveyance was executed by the parties on 27-12-2011. It is pertinent to note that in the facts under consideration the assessee purchased another residential flat on 4-10-2010 and considering the agreement to sale as the relevant date of transfer, claimed an exemption u/s. 54 of the Act. During the course of assessment proceedings, the learned AO denied exemption as claimed by the assessee by treating the date of registration of a conveyance deed i.e. 27-12-2011 as a date of transfer and holding that a new property was not purchased within one year prior to the date of transfer of an old asset. On appeal, the learned CIT(A) confirmed the action of the learned AO. Aggrieved by the same, the assessee filed an appeal before Hon'ble ITAT but did not find any success. Thereafter, an appeal was preferred to Hon'ble ITAT. After considering contentions of both the parties, Hon'ble ITAT observed as under:

Held

Hon'ble ITAT observed that, to avail the benefit of section 54 of the Act, the assessee must purchase a new residential house within one year before or two years after the date on which transfer of the old residential house. Hon'ble ITAT held that in the present case the residential house was transferred by the assessee *vide* sale deed registered on 27-12-2011. However an agreement to sell was executed on 16-9-2011 and a sum of ₹ 1 lakh was received by the assessee as earnest money. Hon'ble ITAT perused the definition of transfer as contained in section 2(47) of the Act and also referred to the decision of Hon'ble Apex Court in the case of *Sanjeev Lal in Civil Appeal No: 5899-5900 of 2014 (SC).* Further, Hon'ble ITAT after considering the decision of Hon'ble Apex Court in the case of *S. Kadevi vs. V. R. Somasundaram 2013 (4) MPHT* observed that Hon'ble Supreme Court in the aforesaid case has opined that when an unregistered document is tendered in evidence, not as evidence of a completed sale, but as proof of an agreement of sale, the deed can be received in evidence making an endorsement that it is received only as evidence of an oral agreement of sale under the proviso to Section 49 of the Act of 1908. Finally, Hon'ble ITAT came to the conclusion that the date of agreement to sale is to be considered as a relevant date of transfer in the facts under consideration and allowed an exemption of section 54 to the assessee. The Appeal was decided in favour of the assessee and against the department.

4. Reopening – Section 147 of the Act – If objections raised by an assessee are not adjudicated and

disposed off by an assessing officer as per the law laid down by Hon'ble Apex Court in the case of *"GKN Drive Shafts (India) Ltd vs. ITO (2003) 259 ITR 19 (SC)*, reassessment proceedings are bad in law and need to be quashed

Baldev Ramratan Sharma vs. ACIT, Circle- 21(1), Mumbai (ITA 1909/Mum/2017) [Assessment Year: 2009-10] order dated 28-8-2018

Facts

The assessee is an individual and the Assessment Year under consideration is 2009-10. For the said assessment year, the case was reopened and the notice u/s. 148 of the Act was issued to the assessee. During the course of reassessment proceedings, the assessee filed a return of income, asked for reasons recorded by the learned AO and objected to the said reasons *vide* his letter dated 30-4-2014. However, the learned AO completed the said proceedings without disposing off the objections filed by the assessee before him. Aggrieved by the same, the assessee preferred an appeal before the learned CIT(A) but did not find any success. Thereafter, the assessee filed an appeal before Hon'ble ITAT. During the course of hearing, the learned AR submitted that the reassessment proceedings framed by the learned AO are bad in law since the learned AO failed to dispose off the objections of the assessee and did not comply with the law laid down by Hon'ble Apex Court in the case of *"GKN Drive shafts (India) Ltd. vs. ITO (2003) 259 ITR 19 (SC).* To buttress his submission, the learned AR relied upon the decision of Hon'ble Bombay High Court in the case of *KSS Petron Pvt. Ltd. vs. ACIT in ITA No: 224 of 2014 (Bom.)* and another decision of Hon'ble ITAT Mumbai Bench in the case of *DCIT vs. National Bank for Agriculture and Rural Development in ITA No: 4694/Mum/2014.* The submission of the learned AR was vehemently opposed by the learned DR and it was submitted to Hon'ble ITAT that recently in the decision of *Home Finders Housing Ltd. vs. ITO (2018) 93 taxmann.com 371 (Madras)*, Hon'ble Madras High Court held that non-compliance of procedure indicated by the Supreme Court would not render the order void or nonest since the same is a procedural irregularity which can be cured by remitting the matter to the AO. It was further pointed out to Hon'ble ITAT that the SLP preferred against the said decision has been dismissed by Hon'ble Supreme Court [2018] 256 Taxman 59 (SC). In the rejoinder, the learned AR submitted that in the case of dismissal of SLP, Hon'ble Supreme Court nowhere lays down any law but merely denies to exercise its appellate jurisdiction. The learned AR of the assessee relied upon the decision of Hon'ble Apex Court in the case of *Kunhayammed vs. State of Kerala (2010) 245 ITR 360 (SC).* After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT came to the conclusion that the aforesaid issue under consideration stands concluded in favour of the assessee and against the department by the decision of Hon'ble Bombay High Court in the case of KSS Petron Pvt. Ltd. It was further observed by Hon'ble ITAT that even Hon'ble Delhi High Court in the case of *PCIT vs. Tupperware India (P) Ltd. (2016) 65 taxmann.com 17 (Delhi)* took the same view. In the light of the aforesaid observations, Hon'ble ITAT allowed the appeal filed by the assessee.

5. Tax Collected at Source – Section 206C of the Act – Where no limitation is prescribed u/s. 206C for passing an order by the Assessing Officer holding assessee in default for failure to collect tax at source, an assessing officer is required to pass

the same within reasonable period of limitation of four years and it is not open for an assessing officer to pass such an order at any point of time

ITO, TDS-3, Jaipur vs. Eid Mohammad Nizamuddin and Eid Mohammad Nizamuddin vs. ITO, TDS-3, Jaipur (ITA 316/JP/2018 and ITA 248/JP/2018) [Assessment Year: 2009-10], order dated 29-8-2018, [2018] 97 taxmann.com 502 (Jaipur - Trib.)

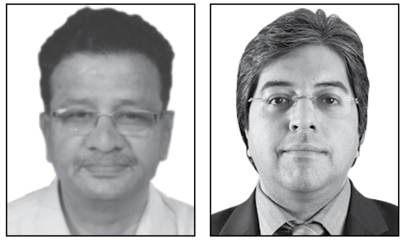
Facts

The assessee is a partnership firm, engaged in the business of manufacturing and trading of bidi. The assessment year under consideration is 2009-10. For the year under consideration, the survey proceedings u/s. 133A(2A) of the Act took place at the business premises of the assessee on 23-3-2015. During the course of the said proceedings, it was found that the assessee was engaged in the business of trading of Tendu leaves and was liable to collect tax at source (TCS) at the rate of 5 per cent on sale of Tendu leaves as per provisions of section 206C(1) of the Act. However, the assessee did not collect the same. The learned AO passed an order on 30-3-2016, holding the assessee as an assessee in default within the meaning of section 206C(6), read with section 206C(7) of the Act for non-collection of tax including interest. Aggrieved by the same, the assessee preferred an appeal before the learned CIT(A) and objected to the validity of the order on the ground of limitation. However, the assessee did not find success on the said ground. Being aggrieved, the assessee preferred an appeal before Hon'ble ITAT. During the course of the hearing, the learned AR submitted that the said section does not provide any time limit to pass an order and therefore an order is to be passed within reasonable time limit. It was further submitted before Hon'ble ITAT that while dealing with the similar issue where there was no time limit to pass an order u/s. 201 of the Act prior to amendment, various judicial forums considered a period of four years as reasonable period. On the other hand, the learned DR vehemently opposed the contentions of the learned AR. After hearing both the parties, Hon'ble ITAT held as under:

Held

Hon'ble ITAT observed that there is no dispute that section 206C or any other provisions of the Income-tax Act do not provide any limitation for passing the order by the Assessing Officer under Section 206C(6)/206C(7) holding the assessee in default due to failure to collect tax at source. However, non-providing the limitation in the statute would not confer the jurisdiction/ powers to the Assessing Officer to pass an order under section 206C at any point of time disregarding the amount of time lapse from such default of collection of tax at source. It further observed that the provisions of Section 206C are analogous and a measure for compliance of collection of tax at source as a similar measure for compliance of deduction of tax at source is provided under section 201 of the Act. Hon'ble ITAT thereafter referred to various decisions relied upon by the learned AR and held that a period of four years is to be considered as reasonable period for passing an order u/s. 206C(6)/206C(7) of the Act. The contention of the assessee on validity of the order was allowed in favour of the assessee.

> Gratitude and hospitality are the peculiar characteristics of Indian humanity.
>
> — *Swami Vivekananda*



CA Tarunkumar Singhal & Sunil Moti Lala, *Advocate*

INTERNATIONAL TAXATION
Case Law Update

A. HIGH COURT

1. Even if the assessee opts to be governed by the provisions of the India-UK DTAA, in absence of tax computation mechanism in the said DTAA, income is to be computed as per the provisions of the Act considering the grossing up provision of section 195A and then the rate of tax as per the Act or the DTAA, whichever is more beneficial, would be applicable

TVS Motor Company Ltd. vs. ITO – [T.C. (Appeal). Nos.1509 to 1513 of 2007 (Mad)]

Facts

1. The assessee had entered into an agreement with the University of Warwick for provision of technical services and according to the terms of the agreement, the tax was to be borne by the assessee.

2. The AO was of the view that tax had to be deducted even on the tax payment to be made by the assessee and the principle of grossing up would be applicable. The AO by applying provisions of section 195A of the Act, grossed up the income by the tax component of the remittance and held the assessee to be an 'assessee-in-default' u/s. 201(1)/ 201(1A) of the Act for short deduction of tax at source u/s.195 of the Income-tax Act,1961, as the assessee had not deducted tax on the amount of 'grossing up'..

3. The CIT(A) upheld the AO order and rejected the assessee's contention that the application of the 'grossing up provisions' is against the beneficial provisions of DTAA between India and UK opted for by the assessee, since the percentage of tax rate by grossing up would go beyond 15% of the gross receipts (being the rate stipulated in Article 13 of the said DTAA). The Tribunal affirmed the CIT(A)'s order.

Held

1. The Court rejected the argument of the assessee that since no grossing up is provided for under Article 13 of the India UK DTAA, it was liable to pay tax at the rate of 15% on the amounts specified in the agreement.

2. The Court agreed with the reliance placed by the Revenue on the decision in the case of Tata Ceramic Ltd. [(2011) 15 taxmann. com 49 (Ker)] wherein it was held that only if the tax does not form part of income [say,

on account of exemption u/s 10(6A)], there would be no grossing up of such tax for the purpose of TDS.

3. The Court accepted the stand of the Revenue that since the term "gross amount" is not defined under the provisions of the DTAA, the definition of income as defined under section 2(24) of the Act had to be referred which includes payments net of taxes. It held that since the tax computation mechanism was not provided for in the treaty, the income had to be computed under the Act and on that income computed, the rate of tax as per the provisions of the Act or the DTAA whichever was more beneficial would be applicable. Thus, it held that the provisions of Section 195A of the Act were applicable to the assessee's case.

4. Therefore, it held that since the assessee had undertaken to discharge the tax liability of University of Warwick as per the terms of the agreement, the same had to be added to the latter's income and the principle of grossing up was applicable.

2. Consideration paid to a USA Company for assisting the Indian company in taking correct decisions and no transfer of technical knowledge, did not amount to 'Fees for Included Services' under the DTAA between India and the USA.

US Technology Resources (Pvt) Ltd vs. CIT [ITA No.38 of 2014 (Mad)]

Facts

1. The assessee-company made payments to a USA company for rendering management, financial, legal, public relations, treasury and risk management services without deducting tax at source. The AO held the said payments to be in nature of "Fees for Technical Services (FTS)" taxable in India as per the provisions of section 5(2) r.w.s 9(1)(vii) of the Act. He, thus disallowed the said payment claimed as expenditure u/s 40(a)(ia) and also passed an order under section 201 of the Act for non-deduction of tax at source.

2. The First Appellate Authority (FAA) confirmed the AO's order and held that the services offered by the US Company fell within the purview of FIS, relying on the decisions of the Apex Court in the case of *GVK Industries Ltd. [2015] 717 ITR 453 (SC), Continental Construction Ltd [(1992) 1954 ITR 81]* and *Oberoi Hotels India (P) Ltd. [(1998) 97 taxman 453]* wherein it was held that Explanation 2 to section 9(1)(vii) of the Act takes within the ambit of term "FTS", managerial, technical or consulting services including the provision of services of technical or other personnel.

3. The Tribunal also concurred with the CIT(A)'s finding and held that the US Company had facilitated the assessee to take decisions in the managerial, financial and risk management aspects by transferring knowledge, expertise etc. required for the said decision making . It thus held that the said payment was covered by the definition of the term "Fees for included services" under Article 12 of DTAA between India and USA.

Held

1. The Court observed that there was no dispute that the said services were taxable as per the provisions of the Act since the income was deemed to accrue or arise in India since it fell within the definition of "technical services" under the Act.

2. Further, it held that it was an admitted fact that the US Company did not have a PE in India, and hence the business profits accruing to it from India would be taxable only in USA unless it was "royalties or Fees for included services" under the India-US

DTAA. It was pointed out that the term 'fees for included services' as defined under the DTAA would take in payment of any kind in consideration for the rendering of any technical or consultancy service, which are distinctly defined under the DTAA, and the said term is different from the term 'technical and consultancy services' as defined under Section 9(1)(vii) of the Act.

3. It held that as per sub-clause (b) of Article 12(4) of the India USA DTAA, services which do not make available technology to the person acquiring the service were specifically excluded from definition of the term 'fees for included services' given under the DTAA. The Court held that, there should not be a mere technical input but a clear transfer of technology with the transferee applying to its business. It also referred to the illustration in MOU of the India USA DTAA to support this finding with respect to transfer of technology.

4. The Court disregarded the Apex Court decisions relied on by the FAA and the Tribunal since in those decisions the aspect of taxation had been dealt with under the Act and not under the treaty.

5. The Court held that the facts of the instant case were similar to the case of De Beers India Minerals (P) Ltd. [(2012) 208 Taxman 406 (Kar)] where the Indian Company had sought for assistance of a Netherlands Company to conduct airborne survey for providing high quality, high resolution, geophysical data to identify targets and latter company merely transferred the data (maps, photographs) collected during the survey carried out by its equipment and processed to identify the mining sites. Hence, in that case, it was held that there was no transfer of technology but mere transfer of data.

6. The Court held that in the present case also neither there was any technology transfer nor was there a plan or strategy relating to the management, finance, legal, public relations or risk management which was transferred to the assessee. It held that the non-resident company only assisted the Indian Company in making correct decisions on aspects specifically referred to in the agreement as and when advice required.

7. Accordingly, the Court held that there was no obligation for tax to be deducted at source and set aside the proceedings under section 201 of the Act. Further, it directed the AO to consider the claim of expenditure afresh without looking at the application of section 195(1) of the Act.

3. Distinction between BPO and KPO service providers upheld but Provision of Knowledge Management Services, KPO and not BPO activity.

McKinsey Knowledge Centre India Pvt. Ltd vs. Pr.CIT [ITA 461 of 2017 (Bom)]

Facts

1. The assessee-company, a wholly owned Indian subsidiary of McKinsey Holding Inc., USA, was engaged in business operations broadly divided into 2 segments viz. Research and Information (R&I) Services and IT Support Services.

2. The R&I Services Division could be further divided into through 3 sub-groups- (a) Knowledge On Call Group – providing journalistic research information support. The services offered include financial analysis. (b) Practice Research Group - focusing on domain specific research support. The services provided included sector data and analysis, capital market insights, perspectives and industry trends and (c) Analytics Group - focusing primarily on time intensive analysis requiring expertise and analytical tools and techniques. The services provided included data analysis, model/tool development,

proprietary database management, practice specialized analytics.

3. Based on the examination of the master service agreement between the assessee and McKinsey USA, the Tribunal held the nature of services provided by the assessee under the R&I segment were in nature of knowledge process outsourcing ["KPO"] since the assessee was offering knowledge-based services.

4. In the view of the assessee, it functioned like a business process outsourcing ["BPO"]. The assessee contended that the R&I division carried out research from the internet database and compiled the data which was further customized in accordance with the requestor party before transmission to the overseas group company so that McKinsey group entities could consider them before providing consultancy services.

5. Aggrieved, the assessee filed an appeal to the High Court against the order of the Tribunal.

Held

1. The Court examined the master services agreement entered into between the assessee and McKinsey USA for providing both the R&I and also the IT support services. The Court observed that on perusal of the agreement it was evident that the assessee's function were inclusive of "knowledge management systems and infrastructure issues which would encompass infrastructure support, application support, application operations group and survey development centre". It thus held that the Tribunal's finding that since the assessee provided high end services in terms of R&I segment, it was offering knowledge based service, was in alignment with the agreement.

2. So far as the distinction between BPO and KPO was concerned, the Court relied on the ruling in case of Rampgreen Solutions Pvt Ltd [(2015) 60 taxmann.com 255 (Del)] where BPO and KPO have been plainly understood in the sense that whereas, BPO does not necessarily involve advanced skills and knowledge; KPO on the other hand would involve employment of advanced skills and knowledge for providing services. Thus, in that case, it was held that the expression "KPO" in common parlance was used to indicate an ITes provider providing a completely different nature of service than any other BPO service provider.

3. Accordingly, following the ratio laid down in aforesaid decision of Delhi High Court, the Court held that since the services rendered by the assessee were specialized and required specific skill based analysis and research that was beyond the rudimentary nature of services rendered by a BPO, the services provided by the assessee were more akin to KPO.

4. Tribunal's order upholding 0.5% as arm's length for guarantee commission, upheld. Share application money advanced by the assessee to its AE could not be characterised as loan merely because of delay in receipt of share certificates (so as to warrant TP adjustment of interest on such alleged loan)

Pr.CIT vs. Couceutrix Services India Pvt. Ltd. (ITA No.303 of 2016) (Bom)

Facts

1. The assessee-company had issued a corporate guarantee in favour of its subsidiary/ AE so as to enable it to avail a loan from bank. However, the assessee did not classify such transaction as an international transaction in the TP Study.

2. The TPO took the difference between the PLR rate and bank rate during the relevant period as arm's length price of the corporate guarantee provided by the assessee at the rate of 3% and further added clerkage charges of 0.25% and thereby arrived at 3.25% as arm's length guarantee charges in respect of corporate guarantee provided by the assessee. Accordingly, the TPO made an addition to the guarantee commission

3. With respect to another transaction, being certain amount advanced by the assessee to its subsidiary/ AE in form of share application money, the TPO re-characterized the same as loan advanced to its AE.

4. On appeal, the Tribunal directed the TPO/AO to adopt 0.5% as the ALP of the guarantee commission charged. With respect to TP adjustment of interest, it noted that the only reason for recharacterizing the share application money as loan was delay in receipt of share certificates from the AE and accordingly, the Tribunal remanded back the issue to AO so that the assessee could furnish the said certificate.

5. Aggrieved, the Revenue filed an appeal to the High Court against the Tribunal order restricting the ALP rate for guarantee commission to 0.5% and also on the question as to whether the Tribunal erred in holding that the money advanced to the AE was to be treated as share application money and could not be nomenclated as loan thereby deleting the TP adjustment on account of interest thereon.

Held

1. The Court held that the issue of guarantee commission was squarely covered by the decision of Bombay High Court in the case of *CIT v. Everest Kanto Cylinder Ltd [2015] 378 ITR 57 (Bom)* wherein the Court had upheld the Tribunal's order restricting the ALP for corporate guarantee commission to 0.5% as against the rate of 3% adopted by the TPO considering the rates for bank guarantee. In the said case, the Court had held that the consideration which applied for issuance of corporate guarantees were separate and distinct from the bank guarantees. Further, it held that the comparison could not sustain since it was not between like transactions but were between guarantees issued by commercial bank on one hand as against the corporate guarantee issued by the holding company for the benefit of its AE.

2. As regards the amount of share application money being treated as loan, the Court noted that the Tribunal had not answered the question clearly in favour of the assessee and the Tribunal had only held that subject to verification of the share capital by the AO, the share application money could not be treated as loan amount because of mere delay in issuance of shares by the subsidiary in the name of assessee.

3. Accordingly, on both the issues, the Court held that no substantial question of law arose and thus dismissed the appeal of the Revenue.

5. Tribunal's order excluding Motilal Oswal Investment Advisors Pvt. Ltd., as a comparable for non-binding investment advisory upheld

Pr.CIT vs. NVP Venture Capital India Pvt. Ltd (IT No. 406 of 2016)(Bom)

Facts

1. The assessee-company was engaged in providing non-binding investment research and related services to its AE in Mauritius. The advisory services included providing reports on a timely basis containing news and information on investment areas, industries,

companies and other specific areas that may interest the Mauritian entities.

2. The assessee adopted TNMM to benchmark its international transaction of providing the aforesaid investment advisory services to its AE. The TPO accepted the use of TNMM to be the MAM, but included Motilal Oswal Investment Advisors Pvt. Ltd. ["MOIL"] as a comparable. The assessee contested the said inclusion on the ground that it was functionally not comparable to the assesee's activities and further that it derived income from four business verticals viz. equity capital markets, mergers and acquisitions, private equity syndications and structured debt.

3. The Tribunal excluded the said comparable as it was engaged in qualitatively different and diversified business from that of the assessee which was confined to only rendering non-binding investment advisory services. It also relied on its own decision in the case of Carlyle India Pvt. Ltd (ITA No.2200/Mum/2014) wherein it was held that MOIL was declaring a solitary stream of operating income under the head "advisory fee" but engaged in diversified activities without segmental information in respect of each of them.

4. Aggrieved, the Revenue filed an appeal to the High Court against the order of the Tribunal.

Held

1. The Court held that the factual finding of the Tribunal was not perverse and it was in full agreement with respect to the Tribunal's findings that MOIL was engaged in diversified activities and no segmental information was available in respect of such activities.

2. Hence the Court held that no substantial question of law arose and accordingly it dismissed the appeal of the Revenue.

B) Tribunal Decisions

I) Preparatory activities performed prior to entering into contract cannot be included to compute duration for determining installation PE

Bellsea Ltd vs. ADIT [TS-426-ITAT-2018(DEL)]
Assessment Year: 2008-09

Facts

(i) The assessee was a Cyprus based company engaged in the business of dredging and pipeline related services for oil and gas installations.

(ii) The assessee was awarded a contract (by a main contractor) for placement of rocks in the seabed in Indian waters for protection of gas pipelines and sub-sea structures in the oil and gas field.

(iii) Before entering the contract, an employee of the assessee visited India to collect data and information necessary for tendering purposes. Before the Income-tax officer (ITO) the assessee claimed that it did not meet the 12 months threshold provided for installation PE as per Article 5(2)(g) of the India-Cyprus tax treaty. The period between the effective date of commencement (i.e. date provided in the contract) and date of completion (i.e. date of issuance of completion certificate) did not exceed 12 months.

(iv) The ITO, after examining the scope of work of the main contractor, concluded that the assessee was responsible for multifarious functions. Thus, it could not be said that the role of assessee was limited only to rock placements, to be covered under the ambit of Article 5(2)(g) (installation PE clause) of the India-Cyprus tax treaty.

(v) Furthermore, the TO held that even assuming that the activities were covered under the installation PE clause, the assessee was carrying on such activities for more than 12 months as the commencement should have been reckoned from the date of arrival of the employee of the assessee in India for preparatory work. Therefore, the TO concluded that the assessee constituted an installation PE in India as per Article 5(2)(g) of the tax treaty.

(vi) The Dispute Resolution Panel (DRP) confirmed the TO's action regarding the establishment of installation PE. Aggrieved by the above, the assessee filed an appeal before the Tribunal.

(vii) The assessee submitted as under:

(a) In relation to the threshold period for installation PE, the contract itself provided for the relevant duration to be considered, as it mentioned both the effective date of commencement and the completion date.

(b) Even if the period of actual activity was to be considered as the duration, the payment schedule and its break-up in the contract provide that the activities of mobilisation and demobilisation did not exceed the threshold of 12 months for constituting an installation PE as per the tax treaty.

(c) In relation to the allegation that the date of commencement should have be reckoned from the date of visit of the employee, the assessee submitted that the activities performed by such employee was not for any kind of installation activity but was necessary for tendering purposes.

(d) Such activities could not be treated as part of installation activity, as stipulated in Article 5(2)(g) of the tax treaty and reliance in this regard was placed on the judgement of the Delhi High Court (HC) in the case of *National Petroleum Construction Company v. DIT [2016] 383 ITR 648 (Delhi).*

(viii) The Tax Department submitted as follows:

(a) The date of commencement should not have been reckoned from the effective date of the contract because the contract only indicated that the assessee's personnel were required to visit India and such visit did take place prior to the effective date of the contract.

(b) Furthermore, the date of arrival of vessel/ barge should not have been taken as date of commencement of activities as the entire activity qua the contract had to be considered. Reliance in this regard was placed on various clauses of the contract and it was highlighted that the assessee's responsibilities included various activities such as pre-installation activities and obtaining various permits and authorisations.

(c) Accordingly, the Revenue contended that the assessee exceeded the threshold period of 12 months and constituted an installation PE.

Decision

The Tribunal held in favor of the assessee as under:

(i) After perusing the various agreements, the Tribunal observed that the scope of work noted by the TO was that of the main contractor. Thus, the inference of the same by the TO was incorrect, as the assessee's scope was different and more limited.

(ii) In respect to date of commencement, the Tribunal observed that the duration of 12 months provided in clause 5(2)(g) of the tax treaty per se was activity specific in relation to the site, construction, assembly or installation project.

(iii) The Tribunal placed reliance on the ratio laid down by the judgment of the Delhi HC2 relied by the assessee and noted that the building site or construction, or assembly project, would commence on the commencement of activities relating to the project or site.

(iv) An activity that may be related or incidental to the project but which was not carried out at the site would clearly not be construed as a PE. The Tribunal observed that preparatory work at the site itself could be counted for the purpose of determining the duration for PE, but that was not the issue to be dealt with in the present case.

(v) The Tribunal noted that the employee of the assessee who visited India for conducting pre-survey engineering investigation of site, etc., for tendering purposes had performed preparatory activities without actually entering into the contract.

(vi) Therefore, the Tribunal held that activity of the assessee was without any economic substance or active work qua the project, and could not be construed as carrying out any activity of installation or construction. Accordingly, the Tribunal held that the activities performed by the employee of the assessee could not be considered while determining the duration for determining installation PE.

(vii) Thus, the Tribunal held that period of commencement was to be reckoned from the date from which the enterprise started performing its activities in connection with the installation project and not any date prior to that.

(viii) In relation to the date of completion, the Tribunal observed that the activity qua the project ends when the work was completed and the responsibility of the contractor with respect to that activity came to an end.

(ix) Accordingly, in view of the facts and material, and in consonance of the principle laid down by the Delhi HC2, the Tribunal held that the threshold period of 12 months was not exceeded in the present case. Consequently, no installation PE was held to be established as per Article 5(2)(g) of the tax treaty.

II) Provisions of section 56(2)(viib) not applicable where the company had only closely related shareholders and there was no possibility of unaccounted money being involved

M/s. Vaani Estates Pvt. Ltd vs. ITO – [TS-529-ITAT-2018(CHNY)] – Assessment Year: 2014-15

Facts

(i) The assessee engaged in real estate business had two shareholders, i.e., Mrs. A and Ms. B (being mother and daughter, respectively) each holding 50% stake.

(ii) Mrs. A subscribed to 10,100 shares of the assessee, at a premium.

(iii) The revised shareholding of the assessee was 75% and 25%, held by Mrs. A and Ms. B, respectively.

(iv) Subsequent to infusion of capital by Mrs. A, the assessee acquired a land.

(v) On assessment, the Income-tax officer (ITO) made additions under the provisions of section 56(2)(viib) of the Act.

(vi) The First Appellate Authority upheld the ITO's Order.

(vii) The assessee contended as under

(a) Section 56(2)(viib) of the Act was introduced to deter the generation and use of unaccounted money through infusion of funds from unconnected persons/ shareholders at a substantial premium, which ultimately confers the benefit to existing shareholders by enhancing the value of their shareholding.

(b) The fair market value (FMV) of the assessee after acquisition of land was equal to FMV computed in accordance with section 56(2)(viib) of the Act.In the instant case, Mrs. A undertook the infusion for the specific purpose of acquiring land.

(c) As the money was brought in by an existing shareholder for the specific use of the assessee (and not for the benefit of other shareholders), the provisions of section 56(2)(viib) of the Act could not be attracted.

(d) Even if, the introduction of funds at a very high premium had benefitted Ms. B, the transaction would not be subject to tax in view of the relative exemption under section 56(2)(x) of the Act.

viii) The Tax Department contended as under:

(a) Section 56(2)(viib) of the Act is absolute in its wording and does not provide for any exemptions other than the ones specifically provided.

(b) Section 56(2)(viib) of the Act provides a specific mechanism to determine the FMV.

(c) In addition, the exclusion of "relatives" from the liability of taxation is provided only under sections 56(2)(v), 56(2)(vi) and 56(2)(vii) of the Act, and not under 56(2)(viib) of the Act.

(d) The FMV arrived at by the assessee was subsequent to the receipt of share application money and acquisition of land, and thus, could not be considered for the purpose of section 56(2)(viib) of the Act.

(e) Considering the mechanism prescribed, the infusion by Mrs. A attracted taxation under section 56(2)(viib) of the Act.

Decision

The Tribunal held in favour of the assessee as under:

i) Section 56(2)(viib) of the Act is a deeming fiction introduced to curb the generation and use of unaccounted money.

ii) Mrs. A's source of investment was genuine and not disputed.

iii) Legal fictions should be carried to their logical conclusion within the framework of the purpose for which it is created.

iv) In case of the assessee, the corporate veil is required to be lifted, and thereafter, the transaction has to be viewed in light of relevant provisions.

v) On lifting the assessee's corporate veil, it was evident that a benefit of approximately 25% (revised shareholding) arose to the daughter due to infusion by her mother (i.e. prescribed relatives).

vi) The current infusion would not benefit the other shareholders inducted in future, as the subsequent shares would have to be allotted on the basis of intrinsic value computed based on the mechanism provided under section 56(2)(viib) of the Act.

vii) Thus, on a harmonious reading of section 56(2)(vi), (vii) & (x) of the Act, with the intention of introducing section 56(2)(viib) of the Act and lifting the corporate veil, it was clear that the provisions of section 56(2)(viib) of the Act was not attracted.

viii) Thus, the Tribunal deleted the addition made under section 56(2)(viib) of the Act.

III) GAAR – Mumbai NCLT rejects scheme involving merger of Promoter Holding Company into Listed Company on account of the scheme not being in public interest, potential tax revenue loss and GAAR

Scheme of Amalgamation between Gabs Investments Private Limited and Ajanta Pharma Limited – CSP No. 995 of 2017 and CSP No. 996 of 2017 in CSA No, 791 & 792 of 2017

Facts

i) The Transferee Company is engaged in the business of development, production and marketing of branded and generic formulations and is listed on BSE and NSE.

ii) Transferor Company was incorporated on 4 January 1995. As per the object clause of the Memorandum of Association, the Transferor Company is engaged in the business of investment and dealing in securities. Transferor Company is held by the Promoters of the Listed Co.

iii) The Transferor Company holds 83,92,262 equity shares (~ 9.53 per cent) in the Transferee Company and is part of the 'Promoter group' as per SEBI Regulations

iv) A Scheme of Arrangement involving the merger of GIPL into APL was filed before Mumbai NCLT for approval

v) The Scheme was approved by Board of GIPL on 18 March 2017. It is pertinent to mention that on the same date, GIPL issued 700 shares at a price of INR8 lacs per share to its existing shareholders by way of rights issue.

vi) Salient features of the Scheme were as follows:

(a) Rationale of the Scheme: Scheme was proposed to be undertaken to simplify and streamline the shareholding structure and demonstrate the promoter group's direct commitment to the Listed Company

(b) Pursuant to the Scheme becoming effective, investments of the Transferor Company in the equity shares of the Transferee Company would stand cancelled. The Transferee Company shall issue the same number of equity shares to the shareholders of the Transferor Company

(c) The Scheme would not result in any change in Promoter/ Public shareholding

(d) Promoters would indemnify the Transferee entity from any liabilities or claims that may arise pursuant to the Scheme

(e) Costs in relation to the merger would be borne by the Transferor entity and the Promoters directly.

The Income-tax objected as follows:

i) The Income-tax Authorities, post taking prior approval from the Principal Commissioner of Income-tax, raised various objections in their detailed report submitted to the NCLT. Summary of key objections and observations are as follows:

(a) Transferor Company has to be considered as a Separate Company and accordingly "Assets" of the Transferor Company cannot be transferred and distributed directly without the payment of Dividend Distribution Tax (DDT) at 20 per cent

(b) As per the Memorandum of Association, the primary objective and business of Transferor Company was investing and dealing in shares. Accordingly, any sale of shares of APL would be taxed as business income at 30%. Even in the scenario, GIPL adopts a different method of Computation of Income, the

Authorities highlighted the potential MAT implications at 20%

(c) Based on the above, the Income-tax Authorities argued that total loss to the revenue would be approximately INR421 Cr (~INR287 Cr for business income and subsequent ~ INR134 Cr for DDT) if such scheme was approved

(d) Income-tax Authorities further argued that the Scheme is an 'Impermissible Avoidance Agreement' (IAA) under the GAAR provisions as it is a deliberate measure to avoid tax burden by effectively distributing the shares of the transferee company to its shareholders by using the NCLT as a medium. Further, it is nothing but round trip financing which includes the transfer of funds among the parties to the arrangements through the series of transactions. Therefore, NCLT should reject the Scheme.

Decision

The National Company law tribunal observed and held as under:

i) Based on the recent judgement of NCLAT2 in the case of Wiki Kids Ltd. v. Aventel Ltd. – Company Appeal (AT) No. 285 of 2017Limited, NCLT has the power to reject the Scheme if the same is not in the public interest

ii) As GIPL has been purchasing shares of Transferee Company in the open market only since 2008, the Promoter's claim of the Transferor Company being formed for the sole object of acquiring shares in the Transferee entity was incorrect as GIPL has been in existence since 1995.

iii) The rationale of the Scheme that it would lead to direct involvement of Promoters in the Transferee Company is without any justification

iv) Pursuant to the Scheme, the Promoters would receive shares worth INR1,477.5 Cr on an investment of INR48.7 Crore in the Transferor Company without paying any taxes which is not in the public interest, especially thousands of retail shareholders. Details of compliance with tax liability raised by the Income-tax Authorities has not been clarified by GIPL

v) The NCLT concurred with the objections raised by the Income Tax Authorities that the Scheme has been undertaken to avoid tax burden resulting in potential revenue loss of ~INR421 Cr

vi) Judgements relied on by the Petitioner Companies in relation to locus of Income-tax Authorities and right of an Assessee to arrange its affairs in a certain manner have been rejected on the ground that the same are not applicable in the current fact pattern .

vii) Treatment for the rights issue of 700 shares to Promoters has not been explained keeping in mind the same was issued at a date after the Appointed Date of the Scheme.

viii) The proposed Scheme is a deliberate measure to avoid tax burden and results in misuse of the provisions of the Income-tax Act The scheme had no specific provisions for compliance with SEBI Takeover Code. If the scheme was approved by the bench, the Promoters would escape from complying with such Regulations .The scheme is devised mainly to benefit four shareholders of GIPL who are also common Promoters of APL. The scheme appears to be unfair, unreasonable and is not in the public interest. Accordingly, the Scheme shall not be approved.

Note: The matter will certainly travel to the higher forums for adjudication.

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ML-2 7

CA Divyesh Lapsiwala & CA Amit Bothra

INDIRECT TAXES
GST Gyan

Crossing Borders with GST

With globalisation becoming the norm of the day, transactions, inter-company pricing, supply chains, structuring, and funding are increasingly under the spotlight. More than ever, companies are looking to align their global tax positions with their overall business strategy, to be competitive and provide value to shareholders.

In India, the introduction of GST ensure the following accomplishments –

1. Unified tax regime replacing the diversified overlapping indirect tax structure
2. Removal of State barriers, making the entire country a single market place

As a result, there is a significant boost to ease of doing business from any part of the country as well as making India an attractive location to global business majors encouraging cross-border trade.

Export of goods or services – Zero rated supply and refund of taxes

Since the very inception, the principle that 'taxes should not be exported outside the country' has been adopted in our indirect tax laws. Excise, VAT and service tax were levied on different taxable events but all provided either an outright exemption or *post-facto* benefit for an export transaction.

GST law is no different, export of goods or services outside India is regarded as 'zero-rated supply'. The legislation allows the following options to the exporter:

- pay no taxes on export and claim refund of accumulated input tax credit of input and input services or
- pay IGST on exports (typically by utilising the credit) and subsequently claim 'rebate' of IGST so paid

The concept of refund or rebate has been in operation since a very long time. Over the years, methods and procedures have evolved which have resulted in 'comparatively' speedy disposal of the claims. Under GST the same was expected to reach new heights with the fine print of law specifying the timelines by which a claim needs to be disposed of and granting provisional refund of 90% within seven days of application.

However, GST implementation was marred by infrastructure snag which resulted in a significant delay in filing of refund claims. This impacted the working capital requirement of several companies and resulted in a decrease of outbound cross-border transactions during the initial few months of implementation of GST. Resultantly, the government had to come up with various refund drives to bring some relief to the exporters. Also, the refund formula, prescribed in Rule 89 of CGST Rules, 2017 *vide* Notification No. 39/2018 Central Tax dated 4th September 2018, was recently amended to end confusion around the calculation of refund amount. Several clarifications in relation to refund claims and the procedures to be followed have also been released by the CBIC – all with the intention of bringing quicker and hassle-free refunds to the eligible exporters.

From the look of things, it appears that trouble faced by an exporter may have just got streamlined and an assesse may expect a quick disposal of refund claims made for his outbound cross-border transactions. There is still a need to continuously monitor any ground level difficulty being faced by exports and quickly resolve the same.

Digitization – e-delivery and tax on consumption

Traditionally, trade was restricted to brick and mortar business which used to cater to the local market. But then the Big Bang occurred: thanks to the internet, sellers of goods and services could have immediate access to a global market, and the World Wide Web rapidly became the town square for the global village. Today, a company operating from a garage in Punjab (or any place on the globe with a decent internet connection), can sell its digitised products to millions of customers around the globe without a single sales representative setting foot in a foreign country. The growing digital economy exposed the logical cracks in the taxation system applicable to brick and mortar businesses, and countries became concerned about a loss in revenues because the existing indirect tax rules did not tax consumption of digital products in the country of consumption.

As a consumption tax, indirect tax traditionally applies where the consumption occurs following the so-called destination principle. In cross-border transactions involving tangible personal property, this is achieved by not taxing exports and imposing an indirect tax at the port of entry in the country of import. Cross-border provision of services over the internet has now become extremely common for many digital services. A variety of services such as movies, songs, games, data, healthcare advice, data storage, advertisement, etc., can be made available to any consumer market connected over the internet.

Accordingly, to tap the indirect tax on such electronic delivery, in India GST law has enacted specific provisions to deal with the applicability of GST on online information and database access or retrieval service (OIDAR). GST law ensures that the services 'consumed' in India become liable to tax in India.

OIDAR service can be provided from any remote location outside India. For OIDAR service, where the location of the service provider is outside India and services are to be provided to a registered person in India, the liability to pay GST is on the registered service recipient situated in India – i.e. under the reverse charge mechanism. However, when such services are provided to the non-taxable online recipient, the responsibility towards payment of GST has been casted on the overseas supplier. Such payment could be done through an intermediary or his representative and in case the service provider does not have a fixed establishment in India, he may have to appoint a person to undertake the compliance. This is very similar to the VAT/ GST treatment in several other countries such as Australia, the EU, etc.

Thus, it is imperative that the overseas OIDAR provider is aware of the registration status of its customer. At the time of booking the service, it may be required to ask various details like the country of residence, GST identification number etc. In case GST identification number is kept blank, it may be required to undertake compliance in India. Thus, for cross-border transactions, OIDAR service providers would be required to factor the tax costs.

Non – resident or temporary registration – Ease of doing business

If an overseas company proposes to undertake supply in India for a short span of time, he can opt for registration as 'non-resident' taxable person. The registration and compliance procedures are simpler and thus, a person conducting business with no fixed place of business or residence in India could focus on their business without worrying much about GST. If the non-resident expects a more continuous business from the India market, he can always appoint an agent to register and undertake the compliance without registering themselves.

Cross charge – Free supplies from overseas group entities

Transactions between related persons are of special importance under any law given the pricing methodologies and challenges in arriving at them. Under the erstwhile service tax regime, 'service' had been defined to mean any activity for a consideration carried out by a person for another. Thus the element of consideration was a vital factor for any activity to qualify as service and thus be liable to service tax.

However, under the GST regime, certain activities are to be treated as 'supply' even if made without a consideration. Such activities have been specified in Schedule I of the CGST Act. One such activity which qualifies as supply even when made without a consideration is a supply of goods or services between related persons or between distinct persons. This means there is an additional burden on businesses to identify and value transactions with related persons where no consideration is involved.

There are an array of support activities that companies receive from their overseas group entities for which no consideration is charged. Stewardship services are one classic example of activities that India companies receive from their foreign offices. Stewardship activities typical include supervising accounting, finance and tax departments, and providing inputs with respect to budgetary controls, and planning and ratifying the India operations to ensure conformation with global standards. Valuation and applicability of GST on such free services received from overseas group entities will need to be deliberated upon. Identification and arriving at open market value is going to be a daunting task – e.g., the recent investigation on brand name/ trademark usage.

This issue has already been picked up by tax authorities in case of some of the assesse and thus it is imperative to revisit the position adopted by the companies. It may be noted that companies would be required to undertake the exercise along with its direct tax and transfer pricing teams to ensure that position is aligned in each of the law.

High Sea sales – Proposed amendment

Another classic example of cross-border transaction has been the sale of goods while they are still on high seas. There has been some degree of confusion over levy of GST on such high sea sales. High sea sales is a common trade practice whereby the original importer in India sells the goods to a third person in India before the goods are entered for customs clearance. Such sale is carried out by a transfer in the title to the documents while the goods are still on high seas. As per section 7(2) of IGST Act, the supply of goods imported into India, till they cross the customs frontiers of India, shall be treated as supply in the course of inter-state trade or commerce. By virtue of this provision, high sea sales fall within the ambit of inter-state supply of goods and are thus liable to IGST.

However, recently an amendment has been introduced (yet to be made applicable) to include supply of goods in case of high sea sales in Schedule III of CGST Act – to regard it as neither a supply of goods nor services, not liable to GST. The corollary question, which arises due to treating high sea sales as no supply, is the need for reversal of proportionate input tax credit. In this case, the important point to take cognisance of is that high sea sales have been proposed to be treated as 'no supply' and not 'exempt'. Since high sea sales are not to be treated as exempt supply, no reversal of input tax credit should be required.

Intermediary – Detrimental to supplies consumed outside India

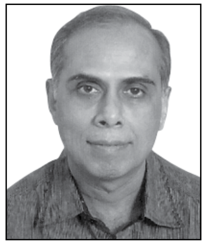
While GST is a consumption or destination-based tax, an exception (continued from the service tax legislation) has been provided for intermediary service under the law. Intermediary means a broker, an agent or any other person, by whatever name called, who arranges or facilitates the supply of goods or services or securities between two or more people but does not include a person who supplies the goods/services or securities on his own account. India is one of the leading providers of financial intermediary services to recipients located outside India. It is imperative for the Government to revisit the taxability of intermediary in cases where the services are consumed outside India. An exemption has been provided to financial intermediary export services provided by GIFT city, Gujarat against foreign exchange receipts.

Challenging times with digital disruption

Beyond the issues discussed above, companies should also prepare for the challenges that some cutting-edge technological developments (e.g., digital currencies and 3D printing) and other disruptive business models (e.g., crowdfunding and crowdsourcing) are beginning to pose for companies within the indirect tax fold.

As long as businesses go through an iterative process and are capable of answering the basic questions governing GST (i.e., who, what, where, when, and how much), they should be able to identify their global GST footprint and related compliance obligations, regardless of the evolution of business models and laws.

New technologies have also been used by Government to increase GST compliance and reduce GST fraud. In recent years, we have observed the spread of e-invoicing and electronic reporting. In the future, it may well be that global organizations will opt for a more direct and secure interchange of data between businesses and authorities, thus obviating the need for issuing invoices, filing returns, and perhaps even audits. While post-GST India is a unified market, technology would soon make the country borders irrelevant for trade.



CA Rajkamal Shah & CA Bharat Vasani

INDIRECT TAXES
GST – Legal Update

NOTIFICATIONS

8th Amendment to CGST Rules (CGST Notification No. 39/2018 dt. 4-9-2018)

- Rule 22(4) amended to provide that where a person instead of replying to the notice furnishes all the pending returns and makes full payment of the taxes along with applicable interest and late fees, the proper officer shall drop the proceedings for cancellation of registration.

- Rule 36(2) under Input Tax Credit Rules amended to provide that where an invoice (document) issued by supplier of goods or services does not contain all the specified particulars but contains the details of the amount of tax charged, description of goods or services, total value of supply of goods or services or both, GSTIN of the supplier and recipient and place of supply in case of inter-state supply, input tax credit may be availed by such registered person.

- Rule 55(5) providing rules for transportation of goods without invoice amended to include supply in batches or lots.

- The formula for the purpose of refund of ITC in sub-rule 4(E) is amended to include turnover of zero-rated supply of services. "Adjusted Total Turnover" u/r. 89(4)(E) is amended now to include the turnover of zero-rated supply of services as determined in terms of sub-clause (D).

- Under refund of integrated tax paid on goods or services exported out of India, Rule 96(10) following retrospective amendment is made w.e.f. 23rd October 2017.

  Any purchaser/importer who are directly purchasing/importing supplies on which benefit of certain notifications (such as Notification No. 78/2017-Customs etc.) as specified thereon has been availed, cannot claim a refund of IGST paid on export of goods or services.

  Earlier such restriction was applicable on the supplies received by a person claiming refunds in regard to which supplier has availed any benefit of prescribed notifications.

- Rule 138A amended to provide that under e-Way rules, in case of imported goods, the person in charge of a conveyance shall also carry a copy of the bill of entry filed by the importer of such goods and shall indicate the number and date of the bill of entry in PART A of Form GST EWB-01.

- The format of FORM GST ITC-04 is amended and FORM GSTR 9 and GSTR 9A is notified.

- **Due date for filing of GST ITC-04 extended** ***[Notification No. 40/2018(CGST) dt. 4-9-2018]***

  Due date for the period July, 2017 to June, 2018 was extended up to 30th September, 2018.

- **Waiver of Late fees for specified classes of tax payers** ***[Notification No. 41/2018 (CGST) dt. 4-9-2018]***

  Late fees paid is waived for following registered persons-

  a) whose FORM GSTR 3B was submitted but not filed after generation of ARN

  b) who have filed FORM GSTR 4 for Oct-Dec, 2017 by due date but late fees was erroneously levied

  c) ISD's who have paid a late fee for the filing of FORM GSTR 6 for any tax period between 1-1-2018 to 23-1-2018.

- **Extension for the time limit for declaration in FORM GST ITC-01** ***[Notification No. 42/2018 (CGST) dt. 4-9-2018]***

  Time limit for filing declaration in FORM GST ITC-01 for registered persons who have filed FORM GST CMP-04 between 2-3-2018 and 31-3-2018 is extended up to 4-10-2018.

- **Extension of due date for filing FORM GSTR-1** ***[Notification No. 43, 44, 45, 46 and 47/2018 (CGST) dt. 10-9-2018]***

  For both quarterly and monthly filers, the due date for filing of FORM GSTR-1 for the period July, 2017 – September, 2018 is extended up to 31-10-2018.

  For quarterly filers registered in the state of Kerala or whose principal place of business is in Kodagu district of Karnataka or Mahe in Puducherry, the due date for filing of FORM GSTR-1 for the quarter July, 2018 – September, 2018 is extended up to 15-11-2018.

  For taxpayers who have obtained GSTIN and received provisional ID but could not complete the migration process pursuant to Notification No. 31/2018 dt. 6-8-2018, the due date for filing of FORM GSTR-1 and GSTR-3B for the period July, 2017 – November, 2018 and for the taxpayers having aggregate turnover is more than 1.5 crore and for the period July, 2017 to September, 2018 the due date is extended up to 31-12-2018.

  9th Amendment to CGST Rules, 2017 ***[Notification No. 48/2018 (CGST) dt. 13-9-2018 & Order No. 4/2018 – GST dt. 17-9-2018]***

  Sub-rule (1A) and the proviso to sub rule 4(b)(iii) inserted u/r. 117 to provide that on the recommendation of GST Council time limit for filing of FORM GST TRAN-1 may be extended up to 31-3-2019 and subsequently that of such FORM GST TRAN-2 up to 30-4-2019.

  Accordingly, the Council hereby extends the period for submitting the declaration in Form GST TRAN-1 till 31-1-2019, for only the class of persons who could not submit the said declaration on account of technical glitches.

- **10th Amendment to CGST Rules, 2017 *[Notification No. 49/2018 (CGST) dt. 13-9-2018]***

  The format of FORM GSTR-9C consisting of 2 parts viz. PART-A: Reconciliation Statement and PART-B: Certification for the purpose of GST Audit notified.

- **TDS & TCS provisions to be applicable from 1-10-2018 *[Notification No. 50 and 51/2018 (CGST) dt. 13-9-2018]***

  TDS provisions u/s. 51 and TCS provision u/s. 52 are notified to come into force w.e.f. 1-10-2018. These provisions shall apply to the persons as notified by Notification No. 33/2017 dt. 15-9-2017.

- **The rate of TCS notified *[Notification No. 52/2018 (CGST) and 02/2018 (ISGT) dt. 20-9-2018]***

  Every electronic commerce operator, not being an agent shall be liable to collect TCS @ 0.5% of the net value of taxable supplies made through it by other suppliers.

- **Amendment to exempt services *[Notification No. 23/2018 (CGST Rate) dt. 20-9-2018]***

  Following Explanation inserted to Entry No. 41 exempting one time upfront amount leviable in respect of the lease of 30 years or more of industrial plots:

  "For the purpose of this exemption, the Central Govt., State Govt. or Union Territory shall have 50% or more ownership in the entity directly or through an entity which is wholly owned by the Central Govt., State Govt. or Union Territory"

  [Similar Notification No. 24/2018 is issued under IGST (Rate) & Notification No. 23/2018 is issued under Union Territory Tax (Rate)]

CIRCULARS

- **Clarification regarding the scope of Principal – Agent relationship in the context of Schedule I of the CGST Act. *(Circular No. 57/2018 CGST dt. 4-9-2018)***

  It is clarified that the Principal-Agent agent relationship shall be covered under the scope of Schedule I only when:

  i) the supply or receipt of goods is undertaken by the agent on behalf of the principal; and

  ii) invoice for the supply of goods on behalf of the principal is being issued by the agent in his name or invoice for procurement of goods on behalf of the principal is received in the name of the agent.

  Thus, if the agent has the authority to pass or receive the title of the goods on behalf of the principal then it gets covered under Schedule I.

  Also, supply or receipt of services between agent and principal is outside the ambit of the entry.

- **Clarification regarding recovery of arrears of wrongly availed CENVAT credit under existing law and inadmissible transitional credit *(Circular No. 58/2018 – GST dt. 4-9-2018)***

  It is clarified that taxpayers may reverse the wrongly availed CENVAT credit under the existing law and inadmissible transitional credit through Table 4(B)(2) of Form

GSTR-3B. The applicable interest and penalty shall apply on all such reversals.

- **Clarification on refund related issues *(Circular No. 59/2018 – GST dt. 4-9-2018)***

  Clarification is issued with regards to following issues relating to refunds:

  i) The statement in Form GSTR-2A is to be given and hard copy of invoices to be submitted only for the entries which are not available in GSTR-2A.

  ii) Statement of invoices in Annexure A to be submitted for determining the eligibility of ITC claimed.

  iii) Total eligible refund is to be apportioned in the following order:

     i) IGST to the extent of balance available in Credit ledger;

     ii) CGST and SGST / UTGST equally to the extent of balance available in credit ledgers and shortfall, if any, the differential amount is to be debited from other credit ledger (for e.g., For shortfall in CGST credit ledger, differential amount to be debited from SGST / UTGST ledger and *vice versa*)

  iv) In case of rejection of claim of refund of unutilised input tax credit on account of ineligibility of credit under sub-sections (1), (2) or (5) of section 17, the proper officer shall re-credit the rejected amount to the electronic credit ledger of the claimant using FORM GST RFD-01B and simultaneously issue demand notice as the case may be.

  On confirmation of demand, the amount to be added to liability ledger through FORM GST DRC-07. Alternatively, the claimant can pay this amount voluntarily along with interest and penalty before service of this demand notice.

  v) In case of rejection of claim of refund of unutilised input tax credit on account of any other reason other than eligibility of credit, the rejected amount shall be re-credited to the electronic credit ledger of the claimant only after receipt of an undertaking from the claimant that he shall not file an appeal against the said rejection or in case he files appeal, the same is finally decided against the claimant.

  vi) Pursuant to retrospective amendment u/r. 96(10) of CGST Rules it is clarified that only those purchasers/importers, who are directly purchasing/importing supplies on which the benefit of reduced tax incidence or no tax incidence under certain specified notifications has been availed, shall not be eligible for refund of IGST paid on export of goods or services.

  vii) It is clarified that the counterpart tax authority shall not withhold any refund amount after sanctioned by proper officer under any grounds except u/s. 54(11).

  viii) It is clarified that once deficiency memo is issued, SCN is not required to be issued. A refund application which is re-submitted after the issuance of a deficiency memo shall have to be treated as a fresh application and order in

FORM GST RFD-04/06 cannot be issued in respect of an application against which deficiency memo is issued.

ix) No refund under section 54(5) or (6) shall be paid to the applicant if the amount of refund is less than Rs. 1,000/-. Further, it is clarified that the limit of Rs. 1,000/- shall be applied for each tax head separately and not cumulatively.

- **Clarification regarding the processing of refund applications filed by Canteen Stores Department (CSD) *(Circular No. 60/2018 – GST dt. 4-9-2018)***

  Manner and procedure for filing and processing of refund claims by CSD is clarified as under:

  Invoice based refund: It is clarified that the refund to be granted to the CSD is for refund based on the invoices of the inward supplies of goods received by them.

  Manual Filing of claims on a quarterly basis: Till the time online utility for filing the refund claim is made available on the common portal, the CSD shall apply for a refund by filing an application in Form GST RFD-10A manually to the jurisdictional officer along with prescribed documents.

- **Clarification regarding the e-way bill in case of storing of goods in the godown of the transporter *(Circular No. 61/2018 – GST dt. 04-09-2018)***

  It is clarified that the e-way bill is required when goods are in movement including when they are stored in the transporter's godown prior to delivery. Further, the transporter's godown has to be declared as an additional place of business by the recipient tax payer.

- **Clarification regarding GST on Priority Sector Lending Certificates (PSLC) *[Circular No. 62/2018 dt. 12-9-2018]***

  GST on PSLC for the period 1-7-2017 to 27-5-2018 will be paid by the seller bank on forward charge basis @ 12%.

- **Clarification regarding the processing of refund claims by UIN entities *[Circular No. 63/2018 dt. 14-9-2018]***

  In order to expedite the processing of refund applications filed by the UIN entities, the following formats/ documents are specified:

  1) Refund checklist which includes covering letter for each quarterly refund, FORM GSTR RFD-10, and FORM GSTR-11, a copy of the letter issued by Protocol Division of the Ministry of External Affairs based on the principle of reciprocity and a cancelled cheque.
  2) Certificate and undertaking in respect of the use of goods and services in accordance with Notification No. 13/2017 IGST (Rate), 16/2017 CGST (Rate) and 16/2017 CGST (Rate) dt. 28-6-2017.
  3) Statement of invoices alongwith copies of only those invoices wherein UIN is not mentioned on the invoice by the supplier.

  Required formats are given in the annexures to the Order.

- **Clarification regarding interception of conveyances for inspection of goods in movement, and detention, release and confiscation of such goods *[Circular No. 64/2018 dt. 14-9-2018]***

  Where a consignment of goods is accompanied with an invoice or any other specified document and also an e-way bill, proceedings u/s. 129

of CGST Act may not be initiated in following situations:

i) where GSTIN is correct but spelling mistake in name of consignor/consignee;

ii) the address is correct but there is an error in pin code provided the error in pin code should not have the effect of increasing the validity period of the e-way bill;

iii) error in the address of the consignee provided locality and other details are correct;

iv) error in 1 or 2 digits of the document no. mentioned in the e-way bill;

v) error in HSN where first 2 digits and rate are correct;

vi) error in 1 or 2 digits/characters of the vehicle no.

In each of the above situations, penalty of ₹ 1,000/- to be imposed.

- **Guidelines issued for Deductions and Deposits of TDS by the DDO under GST *[Circular No. 65/2018 dt. 14-9-2018 and 67/2018 dt. 28-9-2018]***

  Two options have been given viz. a) Individual bill-wise Deduction and its Deposit by the DDO wherein CPIN will have to be mentioned in the bill itself; or b) Bunching of deductions and its deposit by the DDO on weekly, monthly or any other suitable basis. The detailed procedure for payment of TDS under both options is given in the circular.

- **GST on residential programmes or camps by registered religious and charitable trusts *[Circular No. 66/2018 dt. 26-9-2018]***

  With regards to applicability of GST on residential programmes or camps meant for the advancement of religion, spirituality or yoga where fee charged includes the cost of boarding and lodging, it is clarified that such services are exempt as long as the primary and predominant activity, objective and purpose is the advancement of religion, spirituality or yoga.

  However, holding of fitness camps or classes such as those in aerobics, dance, music etc. will be taxable.

PRESS RELEASE

Examination for confirmation of enrollment of GST practitioners dt. 17-09-2018

The National Academy of Customs, Indirect Taxes and Narcotics (NACIN) has been authorised to conduct an examination of GST Practitioners. The GSTP's who have enrolled on GST portal are required to pass the said examination before 31-12-2018.

The exam is scheduled to be conducted on 31-10-2018 from 11:00 am to 1:30 pm at designated centres across India. It will be a computer-based exam. Registration for this exam can be done on this portal - https://nacin.onlineregistrationform.org/

The registration portal will be open up to 10-10-2018. Online payment of examination fee of Rs. 500 is to be made while registration for this exam.

AMENDMENTS IN THE ACT

CGST & IGST Amendment Act, 2018 was passed by the Parliament & Upper House on 30-8-2018 based on recommendations of the 28th meeting of GST Council. However, necessary Notification is not issued awaiting passage by the State Legislatures & UTs. The details of the amendments are not discussed here but will be suitably addressed once the notification is issued giving effect to the Amendment Act.

CA Naresh Sheth & CA Jinesh Shah

INDIRECT TAXES

GST – Recent Judgments and Advance Rulings

A. Writs and Special Leave Petitions

1. Tara exports vs The Union of India – Madras High Court [WP. (MD) No. 18532 of 2018]

Facts, Issue involved and Contention of the Petitioner

The petitioner company is an importer, processor, trader and exporter of cashew kernels. They had attempted to file GST TRAN-1 form on GSTN portal to avail transitional credit upon the implementation of GST. Due to technical glitches in the portal, they could not complete the filing process within the statutory due date i.e. before 27.12.2017.

The petitioner had filed the TRAN 1 form, manually, on 31.01.2018, before the Assistant Commissioner, CGST & Central Excise, Tirunelveli. However, the same was returned with a direction to contact the Help Desk, with a remark that the returns can only be filed online.

Petitioner relied on various cases pronounced by High Courts of India where relief was granted to the taxpayers by directing the authorities to open the portal or accept the manually filed forms. The Circular issued by the Union Government gave relief only to the tax payers who attempted to file TRAN 1 on the GSTN Portal before the statutory due date, i.e. 27.12.2017. Hence the writ petition has been filed to allow re-opening of GST Trans-1 form.

Held

The petitioner has made attempts even to file their return manually, before the Assistant Commissioner, CGST & Central Excise, Tirunelveli, on 31.01.2018, which, in the opinion of the Court, is a genuine attempt made by the petitioner.

GST is a new progressive levy. GST Laws contemplate the seamless flow of tax credits on all eligible inputs. The input tax credits in TRAN 1 are the credits legitimately accrued in the GST transition. The due date contemplated under the laws to claim the transitional credit is procedural in nature. Even under the old taxation laws, it is a settled legal position that substantive input credits cannot be denied or altered on account of procedural grounds. The petitioner has made genuine efforts for filing returns not only through online but also manually, this Court is of the view that the petitioner may be granted the relief as prayed for.

The writ petition is disposed of, so as to enable the petitioner to file the TRAN 1 electronically for claiming the transitional credit or to accept the manually filed TRAN 1, dated 31.01.2018, and allow the input credits, after processing the same, if it is otherwise eligible in law.

2. Builders Association of Navi Mumbai, Neel Siddhi Realties vs. Union of India, Commissioner of GST (Thane), Commissioner of GST (Belapur), CIDCO, State of Maharashtra, Commissioner of GST (Maharashtra) – Writ Petition No. 12194 of 2017 (2018-TIOL-24-HC-MUM-GST)

Facts, Issue involved and Contention of the Petitioner

City Industrial and Development Corporation of Maharashtra Limited (CIDCO) (4th respondent) disposes of land for development for 60 years to various builders and developers under the Navi Mumbai Land Disposal (Amendment) Regulation, 2008 by charging them a onetime lease premium. In addition to this one-time lease premium, a separate lease rental is charged annually for the period of lease.

The members (builders and developers) of the petitioner (Builders association) have obtained a plot in above-mentioned areas. CIDCO then called upon the various allottees to pay GST separately at the rate of 18% on the one-time lease premium amount.

The senior counsel of behalf of petitioners argued that a long-term lease of 60 years tantamount to sale of the immovable property, since the lessor is deprived of, by the allotment the right to use, enjoy and possess the property.

CIDCO is a planning authority. It discharges a Government function and duty. In any event, it discharges a statutory obligation.

By virtue of Article 36, Schedule I to the Maharashtra Stamp Act, 1958, the present transaction should be treated as a conveyance. It conveys a right, title and interest in the immovable property. The whole transaction is akin to the sale of immovable property and section 7 of CGST Act does not have any application.

If the intention of the legislation was to charge GST on this one-time lease premium, then, appropriate provisions would have been inserted in schedule II. One-time lease premium is different and distinct from lease rent. It is not a periodical payment, but a one time. It is not, therefore, conceivable that on such a premium, the tax could be levied, assessed and recovered.

The contention of the respondent

The senior counsel of behalf of the respondents argued that the CIDCO cannot be treated as Government. Its position as a new town planning authority is of no consequence.

The whole edifice of petitioner's senior counsel arguments are based on judgments delivered not in the context of GST Act. The transaction is a supply of service. Income tax Act deals with a tax on income and hence the tests are different. The concepts are also different. It is, therefore, risky to read into one law the definition or provision to similar effect, but from different law.

Held

The GST Act is an Act to make a provision for levy and collection of tax on intra-state supply of goods or services or both by the Central Government and for the matters connected therewith or incidental thereto.

The term "business" is defined in an inclusive manner in section 2(17). The expression includes any trade, commerce, manufacture, profession, vocation, adventure, wager or any other similar activity, whether or not it is for a pecuniary benefit. It also includes any activity or transaction undertaken by the Central Government or State Government or any local authority in which they are engaged as public authorities.

A perusal of sections 7, 8, 9, 10 and 11 falling in this Chapter leaves us in no manner of doubt that the expression "supply" includes all forms of supply of goods or services or both such as sale, transfer, barter, exchange, license, rental, lease or disposal made or agreed to be made for a consideration by a person in the course or furtherance of business.

CIDCO is a person and in the course or in furtherance of its business, it disposes of lands by leasing them out for a consideration styled as one-time premium. If one refers to Schedule II, Item No. 2 styled as land and building and any lease, tenancy, license to occupy land is a supply of service. Any lease or letting out of a building, including commercial, industrial or residential complex for business, either wholly or partly is a supply of service.

The court was therefore of the clear view that the demand for payment of GST is in accordance with law. The said demand cannot be said to be vitiated by any error of law apparent on the face of the record. They dismissed the writ petition as they did not find any merit in it.

B. Rulings by National Anti-Profiteering Authority

3. Shri Jijrushu N Bhattacharya & Director General Anti-Profiteering vs. M/s. NP Foods Franchisee M/s. Subway India (2018 – TIOL-08-NAPA-GST)

Facts, Issue involved and Contention of the Applicant

Mr. Jijrushu purchased 6 Hara Bhara Kabab Sub (“product”) from Subway outlet. The respondent had increased the base price of the product from ₹ 130 to ₹ 145. An application was filed by Mr. Jijrushu before the Standing committee alleging that the Respondent (M/s NP Foods) has not passed on the benefit of reduction in the rate of GST in restaurant service (from 18% to 5%).

The above application was examined by the Standing Committee of Anti-Profiteering and was referred to DGAP (Director General of Anti-Profiteering) for detailed investigation.

The contention of the respondent

Respondent stated that though the rate on restaurant services got reduced from 18% to 5% w.e.f. 15.11.2017, the Input Tax Credit (ITC) on the purchase of material used in the restaurant was specifically disallowed. Thus the respondent increased the base price of his products after the change in the GST rate from 18% with ITC to 5% without ITC. The respondent also submitted copies of the bills, audited balance sheet, GSTR-1 & GSTR-3b and sales register in support of his contention.

Observations of DGAP

The DGAP confirmed in its report that the GST rate of the restaurant service was reduced from 18% to 5% vide Notification No. 46/2017- Central Tax (Rate) dated 14.11.2017 with effect from 15.11.2017.

The DGAP observed that the respondent had availed ITC of 11.8% of the taxable value of the service during the period before 15.11.2017. W.e.f. 15.11.2017 the said ITC will not be available to the respondent.

Analysis of the invoice-wise outward taxable supplies for the period w.e.f. 15.11.2017 to 28.02.2018 revealed that the Respondent had increased the base prices ranging from 6% to 17% of the different items supplied as a part of restaurant service to make good the loss of ITC post GST rate reduction. Respondent had increased the average output taxable value (base price) by 12.14% to neutralise the denial of ITC of 11.80%.

While the increase in the base price of 12.14% was not exactly equivalent to the denial of ITC to the extent of 11.80%, such increase in the base price was commensurate with the denial of ITC. DGAP submitted in their report that the provisions of section 171(1) of the CGST Act had not been violated by the respondent.

Observations of NAPA

It is apparent from the facts of the case that the Respondent had increased the base price of his products to make good the loss which had occurred due to denial of ITC post GST rate reduction.

Respondent had increased the average base price by 12.14% to neutralise the denial of ITC of 11.80% and such increase is commensurate with the increase in the cost of the product on account of denial of ITC. Therefore, the allegation of not passing on the benefit of rate reduction is not established against the Respondent.

Ruling of NAPA

It is clear that the Respondent has not contravened the provisions of Section 171 of CGST Act, 2017 and hence there is no merit in the application filed by the applicant and the same is accordingly dismissed.

C. Rulings by Authority of Appellate Authority for Advance Ruling

4. M/s Giriraj Renewables Private Limited – AAAR Karnataka (2018-TIOL-16-AAAR-GST)

Facts, Issue involved and Query of Applicant

Applicant is engaged in the business of supply and end to end setting up of Solar Power Generating System ("SPGS"). As per the contract entered into with the developer, the applicant is required to do an end to end setting up of solar power plant which includes supply of various goods (such as modules, structures, inverter transformers, etc.) as well as complete design, engineering and transportation, unloading, storage, site handling, installation and commissioning of all equipment's and materials.

The applicant sought an advance ruling on the following question:

1. *Whether supply of turnkey Engineering, Procurement & Construction (EPCI Contract for construction of solar power plant wherein both goods and services are supplied can be construed to be a composite Supply in terms of Section 2(30) of CGST Act, 2017?*

2. *If Yes, Whether the Principal Supply in such case can be said to be 'Solar Power Generating System' which is taxable at 5% GST?*

3. *Whether benefit of concessional rate of 5% of solar power generation system and parts thereof would also be available to sub-contractors?*

The applicant submitted that the major component of SPGS is the Solar Photovoltaic module (PV module) which comprises of around 60-70% of the entire plant. The rest of the components are merely parts or sub-parts and the service portion of the contract is only 10-15%. Hence, the supply of goods should form the principal supply and entire contract should be taxed as the supply of goods itself. They relied on various judgments where the main component of SPGS i.e. Solar Photovoltaic module has been supplied, the same has been held to be a SPGS.

Discussions by and Observations of AAR

As per clause D of the agreement, the PV module was imported by the applicant and then was directly transferred to an owner by way of high sea sales transaction. The owner filled the bill of entry and got cleared the PV module. This indicates that the owner has procured the goods and made them available to the applicant. For a supply to be a composite supply as different goods and /or services supplied should be naturally bundled. The draft contract clearly demonstrates that in such projects the owner can procure the major equipment involved on their own also and the contractor may carry out the supply and services portion in respect of the remaining portion. Thus the concept of natural bundling does not apply to the present envisaged supply.

Since the major component of PV Modules is procured by the owner himself, it cannot be construed as principal supply by the applicant and hence the question is irrelevant.

Sub-contractor is an individual supplier and the rate of applicable GST depends on the type of supply made by him. Concessional rate of GST is not provided to sub-contractor on the basis of the main contractor. Hence the supply made by sub-contractor need to be viewed as an individual supply and thereby the appropriate rate of GST has to be applied.

The ruling of AAR

In respect of question (1), the major component cannot be construed to be supplied by the applicant and hence it cannot be said to be a principal supply of the project and thereby cannot be a composite supply.

Question (2) does not remain relevant on account of the answer to question (1).

In respect of question (3), the supply made by sub-contractor is to be viewed as an individual supply and appropriate rate of GST will be applied.

Appeal to AAAR

Being aggrieved by the above ruling of AAR, the applicant preferred an appeal before the AAAR on the following grounds:

- The proposed transaction is for the composite supply of SPGS as a whole and hence the GST rate would be 5%.
- PV module comprises around 60-70% of the entire plant and therefore they would be the principal supply.
- Merely supplying the PV module on high sea sales basis does not change the nature of the contract. The intention to supply PV module on high sea sales is for commercial convenience and to avail the benefit of concessional rate of customs duty.

The applicant during the personal hearing before the AAAR made the following additional submissions:

- The applicant had placed a purchase order with a foreign vendor for supply of PV module. The title in the PV module was transferred to the project owner vide high sea sales transaction for commercial convenience.
- It was only pursuant to purchase order from the applicant that the foreign vendor has supplied the PV module. The applicant has made payments to

foreign vendors against the purchase order.

- PV module never came in hands of the project owner. It was cleared, transported and installed at the site by the applicant himself.
- BOE also contains the name of the applicant as an original importer.
- Andhra Pradesh High court in case of M/s. Larsen & Toubro Ltd held that nature of procurement of goods does not determine who would be the owner of goods and a person can be an importer even without being the owner of the goods. Hence PV modules cannot be said to be procured by the project owner directly.

Discussions by and Observations of AAAR

The short point for determination is whether the transaction undertaken in terms of the said contract can qualify as "composite supply" and if so, whether the supply of PV module will be regarded as the principal supply.

The scope of the contract is that the applicant will provide all the equipment for setting up SPGS. The word equipment is defined in the contract to exclude free issue equipment. Free issue equipment as per contract means PV modules to be supplied by the owner to the applicant.

Hence, it seems that the applicant has vivisected the contract into two separate parts i.e. first a supply of PV module which constitutes about 60-70% of the contract and the second part is for the supply of remaining parts, components, and services.

Applicant has resorted to a structuring where the supplies are effected in 3 different stages:

- Transfer of ownership of PV module from the applicant to the owner.
- Free issue of equipment by the owner to the applicant.
- Supply of other parts, components, services, etc. by the applicant.

The first supply is out of the scope of GST. The second transaction without consideration is not within the fold of the definition of supply as stated in section 7 of CGST Act.

The transaction of the supply of PV module is abstracted from the rest of the elements of the EPC contract. It is clearly a separate instance of sale from the rest of the agreement.

Supply of PV module is a distinct transaction in itself and cannot be said to be naturally bundled with the supply of remaining parts required for setting up SPGS.

Once the contract is already vivisected into the supply of PV module, what remains to be executed is the supply of other parts and components of SPGS and supply of services (design, erection, installation, etc.). The supply of this remaining portion of the contract in question can still be termed as "composite supply" since they appear to be naturally bundled.

The ruling of AAAR

AAAR modified order of AAR with respect to question (1) is as under:

Supply of major component (PV modules) is not naturally bundled with the supply of remaining parts or components or services of Solar Plant. Supply of PV module is a distinct transaction supplies in the contract in question as it is the owner whose responsibility is to procure and supply of PV Module.

Supply of the remaining portion of the contract in question by the appellant which involves the supply of the balance components and part of the Solar power plant and the services of Erection, Installation, and Commissioning of the Solar Power Plant is viewed as a 'composite supply' as the supply of goods and services are naturally bundled.

D. Rulings by Authority of Advance Ruling

5. M/S Jabalpur Entertainment Complexes Pvt. Ltd. – AAR Madhya Pradesh (2018-TIOL-169-AAR-GST)

Facts, Issue involved and Query of Applicant

The applicant is engaged in the operation of mall and multiplexes. The applicant carries out the following activities:

Activity	Description	The position taken under GST
Cinema house	Consists of 3 movie screens and has a Snack bar	GST paid at 18% on the sale of a ticket (sale price is or below ₹ 100). GST paid at 28% on the sale of a ticket (sale price exceeds ₹ 100).
Mall	They are the owner of South Avenue mall. They have let out space to various brands under rent/revenue sharing basis. They also charge common area maintenance charges to the brands.	GST levied at 18% on rent received from shops. GST levied at 18% on common maintenance charges collected.
Food Court	The food court in the mall is a air-conditioned area with self-service (dine in) and take away arrangements.	GST collected at 5% on the sale of food and drinks (without claiming ITC on food and beverages purchased).

The applicant is claiming ITC of GST paid on the following inward supplies:

- Movie Distributor Share bill (Bill raised by Movie distributor against revenue share of the sale of movie tickets), projector rental bills, advertising bills, security agency, and Housekeeping bills.
- Civil items purchased for maintenance and renovation of the building (as these expenses are not capitalized in the books of accounts)

In the above background, the applicant has sought an advance ruling on the followings:

1. *Whether GST @ 5% can be charged on food, soft drinks, and snacks sold in Snack Bar and Food court in terms of Notification 46/2017?*
2. *Whether ITC of GST paid on movie distributor share bill, projector rental bills, advertising bills, security agency, and housekeeping bills can be claimed in full?*
3. *Whether ITC of GST paid on goods purchased for the purpose of maintenance*

such as Vitrified tiles, marble, granite ACP sheets, Steel Plates, TMT TOR, bricks, cement, sanitary items, etc. can be claimed in full?

4. *Whether ITC of GST paid on Works Contract services received from the registered and unregistered contractor for maintenance contract of the building can be claimed in full?*

The Joint-commissioner vide his letter dated 06.07.2018 furnished the opinion of the department on the above points:

Question	**Department's view**
Whether GST @ 5% can be charged on food and soft drinks sold in the Snack Bar and Food court?	Yes - Supply of food, drinks, and snacks served by the applicant will attract 5% GST.
Whether ITC of GST paid on various cinema house expenses can be claimed in full?	Yes - ITC will be admissible as it is attributable to their output taxable services.
Whether ITC of GST paid on civil materials can be claimed in full?	No – ITC shall be disallowed under section 17(5)(d).
Whether ITC of GST paid on works contract services for maintenance of building can be claimed in full?	No – ITC shall be disallowed under section 17(5)(c).

Discussions by and Observations of AAR

AAR dealt with each of the questions in the following manner:

- Whether GST @ 5% can be charged on food and soft drinks sold in the Snack Bar and Food court?

Notification no. 11/2017 – CT(R) further amended by Notification No. 46/2017 – CT(R) vide its entry at serial number 7, squarely covers the service provided by the Applicant at item no. (i) which reads as under:

> *"Supply, by way of or as part of any service or in any other manner whatsoever, of goods, being food or any other article for human consumption or drink, where such supply or service is for cash, deferred payment or other valuable consideration, provided by a restaurant, eating joint including mess, canteen, whether for consumption on or away from the premises where such food or any other article for human consumption or drink is supplied, other than those located in the premises of hotels, inns, guest houses, clubs, campsites or other commercial places meant for residential or lodging purposes having declared tariff of any unit of accommodation of seven thousand five hundred rupees and above per unit per day or equivalent"*

Above services are classifiable under SAC 9963 and the rate of CGST and SGST is fixed at 2.5% each subject to condition that no ITC has been availed on goods or services used for providing such services.

- Whether ITC of GST paid on movie distributor share bill, projector rental bills, advertising bills, security agency and housekeeping bills can be claimed in full?

It is amply clear that the applicant is operating a mall with multiplex and the services mentioned in this question definitely classifies as input services for providing the declared services by the applicant for furtherance of their business. ITC on such services shall be admissible to the applicant subject to condition that any such input services utilized for providing exempted supplies shall be subject to reversal in terms of Section 17(1) of the CGST Act, 2017.

- Whether ITC of GST paid on goods purchased for the purpose of maintenance such as Vitrified tiles, marble, granite ACP sheets, Steel Plates, TMT TOR, bricks, cement, sanitary items, etc. can be claimed in full?

Section 17(5)(d) of CGST Act prohibits such ITC which reads as under:

> *(d) goods or services or both received by a taxable person for construction of an immovable property (other than plant or machinery) on his own account including when such goods or services or both are used in the course or furtherance of a business"*

Explanation.—For the purposes of clauses (c) and (d), the expression "construction" includes re-construction, renovation, additions or alterations or repairs, to the extent of capitalization, to the said immovable property;"

We find that the materials are squarely covered under the above-mentioned clause as they are used for repairs/renovation/ maintenance, etc. of Mall building which is no doubt an immovable property.

Explanation to sub-section (5) has defined the term construction to encompass all activities'…. to the extent of capitalization. It has been argued that ITC on such expenses can be claimed if the full cost of maintenance is not capitalized. However, capitalization of expenditure depends on the nature of expenditure and benefit accruing from such expenditure. The applicant falls pretty short in elucidating the nature of expenditure i.e. capital or revenue. The mere statement that expenditure is not capitalized cannot come to the rescue of the applicant.

- Whether ITC of GST paid on Works Contract services received from the registered and unregistered contractor for maintenance contract of the building can be claimed in full?

ITC on works contract service is allowable only when works contract service is used as an input service for providing further output service of works contract. Section 17(5)(c) deals with the availability of ITC on works contract service which is as under:

> *(c) works contract services when supplied for construction of an immovable property (other than plant and machinery) except where it is an input service for the further supply of works contract service;*

Repair/ renovation/ maintenance service availed by the applicant for Mall building is fully consumed at the applicant's end. It is not an input service for any further output works contract service. There is no hitch in concluding that ITC in respect of works contract service utilized by the applicant will not be available to them.

The ruling of AAR

In respect of question (1), items supplied in the snack bar and food court shall be chargeable to GST at the rate of 5%.

In respect of question (2), ITC shall be restricted to the apportioned part which is utilized for providing output taxable service.

In respect of question (3), ITC of GST paid on civil items will not be admissible in terms of **Section 17(5)(d)** of the CGST Act, 2017.

In respect of question (4), ITC of GST paid on works contract services will not be admissible in terms of **Section 17(5)(c)** of the CGST Act, 2017.

6. M/s. Chambal Fertilizers & Chemicals Limited – AAR Rajasthan (2018-TIOL-161-AAR-GST)

Facts, Issue involved and Query of Applicant

The applicant is engaged in trading business of goods like DAP, MOP, and other fertilizers.

The said goods are purchased from outside India and imported into India either on CIF basis or FOB basis. The applicable rate of IGST on import as well as on the sale is 5%.

While importing the goods on a CIF basis, the supplier/exporter located outside India is liable to bear the cost of transportation of goods upto India ports. Hence the foreign supplier/exporter avails services of the foreign shipping company for bringing the said goods into Indian ports.

The transportation services provided by the foreign shipping company qualifies to be an inter-state supply and is leviable to IGST u/s 5 of the IGST Act.

The government, in the exercise of their power u/s. 5(3) of the IGST Act issued notification 10/2017 - Integrated Tax (Rate) dated 28.06.2017 (referred to as RCM notification), specifying the following category of service under reverse charge:

Sr. No.	Category of Service	Supplier	Recipient
10.	Services supplied by a person in the non-taxable territory by way of transportation of goods by a vessel from a place outside India up to the custom station of clearance in India	A person located in non-taxable territory	Importer as defined in clause (26) of section 2 of the Customs Act, 1962 located in the taxable territory

The applicant states that importer, in terms of Customs Act, 1962 may or may not be the service recipient and hence, the notification is ultra-vires to the provisions of the Act. Under the service tax regime, the government was empowered to notify the category of service on which tax was payable under reverse charge basis by the service recipient or any other person.

On importing the goods on FOB basis, the cost of transportation is borne by the importer and tax is paid on that component of ocean freight under RCM by the importer.

On importation of goods, customs duty is payable at the time of clearance of goods. Moreover, imports is treated as inter-state supply and IGST is leviable u/s 5(1) of the IGST Act, 2017 read with section 3 of the Customs Tariff Act, 1975.

Section 14(1) of Customs Act read with Rule 10(2) of Valuation Rules clearly provide that custom duty is payable on the transaction value of imported good, which includes the component of ocean freight.

In light of the above, the applicant seeks an advance ruling on the following questions:

1. *Whether in case of import of goods on a CIF basis, the applicant is liable to pay GST on a component of ocean freight paid by a foreign supplier to foreign shipping company?*

2. *Whether for the purpose of determination of the value of goods for payment of IGST on the import of goods (FOB basis), the value of ocean freight (on which tax is paid under RCM) is required to be deducted so as to avoid double taxation?*

Discussions by and Observations of AAR:

Services supplied by the foreign shipping company for transportation of goods in a vessel to a port in India is an 'inter-state supply' in terms of Section 7 of the IGST Act, 2017. Hence IGST is the leviable on the same under section 5 of the IGST Act.

In case of importation of goods on CIF basis, entry no. 10 of notification No. 10/2017 - Integrated tax (Rate) provides that the importer (applicant) is liable to pay GST on the component of ocean freight paid by the foreign supplier to the foreign shipping line.

Section 5(1) of the IGST Act, 2017 makes it clear that levy and collection of IGST on imported goods would be in accordance with the Customs Tariff Act, 1975 and value of imported goods will also be governed by the customs valuation provisions.

Hence valuation of imported goods is to be done by the custom authority under Customs Act, 1962. The question raised by the applicant regarding the determination of valuation of imported goods does not fall under the purview of CGST/RGST Act, 2017 and this issue should be correctly dealt as per the relevant provisions of the Customs Act, 1962.

The ruling of AAR

The applicant is liable to pay IGST under reverse charge on transportation of goods by a vessel under Notification no. 10/2017 – Integrated Tax (Rate) dated 28.06.2017.

Regarding the exclusion of any component of expenditure upon imported goods while determining the value at the time of imports falls beyond the purview of Section 97 of the CGST/RGST Act, 2017.

7. M/s Precision Automation and Robotics India Limited – AAR Maharashtra (2018-TIOL-142-AAR-GST)

Facts, Issue involved and Query of Applicant:

The applicant is engaged in the business of design, manufacturing, procurement, erection, and installation of various types of car parking. Supply and installation of car parking system involves several components, out of which certain components are manufactured by the company while the remaining items are brought out.

The car parking system is either installed in a building or on an independent vacant land. Irrespective of the location, a specific foundation is created and steel / RCC structure (basic frame work of parking system) is erected on such a foundation. This foundation and structure are pre-requisite for successful installation of car parking system.

The applicant generally executes a composite contract with the customers which inter alia includes the supply of parts of car parking system as well as installation and commissioning services – which requires high technical skills, mechanical and mechatronics knowledge, knowledge of safety requirements, etc.

The appellant seeks clarification as to whether the activity of supply and installation of 'Car parking system' would qualify as immovable property and thereby 'works contract' as defined u/s 2(119) of the CGST Act.

The applicant is of the view that the installation of car parking system qualifies as immovable property and is squarely covered under the definition of "works contract" on following grounds:

- General Clauses Act defines immovable property to include things permanently fastened to earth. Supply & installation of car parking system is a permanent fixture attached to building/land wherein it is erected. Hence, it forms a part of immovable property
- Circular No. 58/1/2002 dated January 15, 2002 stated that *"If items assembled or erected at site and attached by foundation to earth cannot be dismantled without substantial damage to its components and thus cannot be reassembled, then the items would not be considered as moveable".* Entire car parking system cannot be moved 'as it is' and necessarily has to be dismantled. It cannot be termed as moveable property.

- Immovable properties are created after installation/assembling of various parts in a systematic manner. Unless all the requisite parts have been assembled or installed in the specified manner, the immovable property does not come into existence and cannot be made functional. Car parking system cannot be functional unless it becomes permanent fixture to land/building.
- Applicant drew analogy from various cases where various courts held that installation of furniture units, central air conditioning system, transmission equipment's installed as a part of telecommunication network are in nature of immovable property.

Discussions by and Observations of AAR

The applicants are indulged in manufacturing and installation of car parking systems since many years and they were clearing and installing the entire car parking system under the Central Excise Tariff Heading 84289090 of Central Excise Tariff Act, 1985. The entire activity of manufacturing, installation and commissioning of car parking systems is duly classifiable under GST Tariff under Chapter Heading 8428 [Other lifting, handling, loading or unloading machinery (for example, lifts, escalators, conveyors, teleferics)].

The service portion of installation of said items i.e. lifts and escalators, is covered under the Service Codes (Tariff) (SAC) No. 995466 under Installation Services Group (Lift and escalator installation services)

The 'car parking system' is not supplied as chattel qua chattel. It is not brought as an identifiable set of goods. The impugned activity is such that the car parking system cannot be said to be supplied unless substantial work is carried out at the site (building or independent vacant land) where the same is to be installed.

Works contract is defined u/s 2(119) of the Act to include activities for building, construction, fabrication, completion, erection, installation, fitting out, improvement, modification, repair, maintenance, renovation, alteration or commissioning of any immovable property wherein transfer of property in goods (whether as goods or in some other form) is involved in the execution of the contract.

Honorable Supreme court in TTG Industries Ltd. Vs CCE, [(2004) 4 SCC] laid down the test that if the chattel is movable to another place for use as such, it is movable but if it has to be dismantled and reassembled or re-erected at another place for such use, such chattel would be immovable.

The impugned car parking system, be it installed on a vacant plot of land or in a building, does not result into a chattel. In fact, before installation, there can be no goods as such which could be called a 'Car parking system'.

The system requires substantial work to be done at the site to be called a 'car parking system'.

Once made operational the 'car parking system' obtains a state of permanency. It is not such as can be easily removed from the existing place and put into place at some other location.

The definition of 'works contract' under the GST Act is in relation to immovable property.

They were, therefore, of the considered view that the transaction of supply and installation of a 'car parking system' would qualify as immovable property and thereby 'works contract' as defined in Section 2(119) of the CGST Act.

Ruling of AAR

The activity of supply and installation of 'Car parking system' is a Works Contract as defined under section 2(119) of the CGST Act, 2017 as it obtains a state of permanency as an immovable property.

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CA Rajiv Luthia & CA Keval Shah

INDIRECT TAXES
Service Tax – Case Law Update

Citation: 2018-TIOL-1948-High Court Madras

Subject : Payment of Pre-Deposit

Case: R Arvind vs. CST, Chennai

Background facts of the case

The petitioner is an Assessee and registered with the Service Tax Commissionerate for rendering service under the category of renting of immovable property. The petitioner preferred an appeal before the CCE (Appeals) on 09.02.2017 against the order in original dated 25.11.2016, which was passed against the petitioner. However, the petitioner did not made payment of pre-deposit along with the appeal. The payment of pre-deposit was made on 27.09.2017, i.e. after a delay of 7 months from the date of filing of the appeal.

The First Appellate Authority, rejected the appeal on the sole reason that the pre-deposit was made belatedly and that in the absence of any provision to entertain the appeal with a delay of more than 7 months, the appeal cannot be entertained & dismissed the appeal for non-compliance of pre-deposit as per Section 35F of the CE Act, 1944.

Hence, the present petition filed before Hon'ble Madras HC.

Observations of the HC

a) There is no dispute to the fact that the petitioner has presented the appeal before the CCE(Appeals) within time. It is also not in dispute that the appeal was not accompanied with the pre-deposit & such deposit was made only after a period of 7 months from the date of presentation of the appeal.

b) Reliance placed on the observations made by the Divisional Bench of this Court in W.A.Nos.342 to 347 of 2017 dated 7-6-2017, wherein it was observed as under :

"A plain reading of the expression, 'presenting' in proviso to Section 128 (1), as against 'entertain' in Section 129 E of the Customs Act, 1962, we come to the conclusion that as long such appeal is presented, i.e., lodged, within the prescribed period of limitation including the condonable period, it cannot be dismissed solely on the ground that the mandatory pre-deposit of duty or penalty or both, was not made, before the expiry of the period of limitation, prescribed under Section 128 (1) read with the first proviso of the 1962 Act."

c) Our conclusions have to be based on the language used in the Act and not based on the likelihood of abuse of the provisions by the litigants.

d) Hon'ble Supreme Court in case of *M/s. Ranjit Impex vs. Appellate Deputy Commissioner and Another, (2013) (10 SCC 655)*, observed that the appellant herein preferred an appeal before the Deputy commissioner I, Commercial Taxes and at the time of presentation, a sum of ₹ 8,52,472 was required to be deposited as per the calculation made under Section 51 of the Tamil Nadu Value Added Tax Act, 2006. The memorandum of appeal was returned back for the reason of non-payment of pre-deposit. The learned Single Judge disposed of the writ petition directing the assessee to comply with all the requirements as intimated by the appellate authority in the return memo dated 3-1-2011 and on such compliance, the appellate authority was directed to register the appeal and dispose of the same in accordance with the Law. In the writ appeal, it was contended that the appellate authority could not have returned the memorandum of appeal on the ground that Section 51 uses the term "entertain" and second, the amount that was due to the appellant from the Department was to be adjusted for the purpose of deposit as envisaged under Section 51 of the Act. **The Division Bench came to hold that the proof of deposit of tax has to be produced at the time when the appeal is taken for consideration but not at the time of presentation of the appeal**. it is needless to say that the conclusion arrived by the Division Bench is absolutely justified, for a condition to entertain an appeal does not mean that the memorandum of appeal shall be retuned because of such non-compliance pertaining to pre-deposit. The only consequence is that the appeal shall not be entertained which means the appeal shall not be considered on merits and eventually has to be dismissed on that ground.

e) Therefore in the instant case, we are inclined to hold that the CCE(Appeals) could not have dismissed the appeals, on the ground that the prescribed mandatory pre-deposit was made, beyond the condonable period.

f) It is also to be noted at this juncture, that the above-said decision of the Division Bench has been accepted by the Revenue and acted upon. Even though the said decision was made by considering the relevant provision under the Customs Act, as it is not in dispute that the present provision viz., Section 35F of the Central Excise Act, 1944 is *pari materia*, I do not think that there will be any difficulty for this Court to apply the above decision of the Division Bench to the facts and circumstances of the present case and grant the relief to the petitioner.

Citation: 2018-TIOL-2594-CESTAT Delhi

Subject: Business Auxiliary Services

Case: Bacardi India Pvt Ltd vs. CST, Delhi

Background facts of the case

The appellants are engaged in the manufacture and marketing of various brands of Indian Made Foreign Liquor (IMFL). They had entered into 3 agreements as under:

- The arrangement with M/s Gemini Distilleries Pvt. Ltd., Bangalore (GDPL) for providing them technical assistance and marketing services in respect of goods manufactured by GDPL under the trademarks owned by M/s. Bacardi and Liechtenstein (Baco)
- Agreement with M/s. White & Mackay (India) Ltd., New Delhi (WMIL) for providing marketing services to them and

also for sale of IMFL manufactured by WMIL or procured by them from other manufacturers.

- Contract with M/s. William Grant & Sons International Ltd., Hong Kong (WGS) for promoting the products of WGS in the markets in India for which appellant received remuneration in convertible foreign exchange

The department alleged that appellants are providing Business Auxiliary services under all the above 3 contracts and hence liable to service tax for the period July, 2003 to March, 2006 on the consideration received under each agreement, respectively.

Arguments put forth

Appellants

a) In respect of an agreement with M/s GDPL, it was merely a Contract Bottling Arrangement where what Bacardi had to manufacture for Baco has got it manufactured from GDPL at a fixed bottling fee. Though appellant was providing marketing services to GDPL but the same cannot amount to Business Auxiliary Service as while providing the said services the appellant was promoting his own product and it was not at all a business support to GDPL who was merely a bottler.

b) With respect to agreement with WMIL, though the services may be categorised as business support service but the levy under Business Auxiliary Services is not sustainable as they came into tax net w.e.f. 1st September, 2009 only.(i.e. BAS services does not include any activity that amounts to manufacture within the meaning of section 2(f) of the CE Act,1944 till 1st Spetember, 2009)

c) With regard to an agreement with WGM, the appellant were exporting the services to the distributors abroad and they were receiving the payments in foreign currency. Service charges so received are exempted from the liability of service tax *vide* a Circular dated 25.04.2003 i.e. regarding non levy of service tax on export of services.

The Respondent reiterated the submissions of the impugned O-I-O.

Decision:

a) It has been a settled proposition of law by Hon'ble Apex Court in the case CCE Pondicherry vs. Acer India Ltd. 2004 (172) ELT 289 (S.C.) = 2004-TIOL-81-SC-CX-LB that if the case is not covered within 4 corners of these taxing statutes, no tax can be imposed by inference or analogy or by trying to probe into intentions of the legislature and by considering what was the substance of the matter. Accordingly, the onus is upon the Department to satisfy us that the services of the appellant in three cases fall within the expressed ambit of the above definition of BAS.

b) The true commercial nature of the contracting bottling arrangement with GDPL appears that *vide* the said arrangement appellant had undertaken bottling operations through GDPL in its role as an entrepreneur and the entire risk and reward in relation to such a bottling activity is to the account of the appellant. GDPL has undertaken bottling of IMFL products of Bacardi brand which is owned by Baco abroad and for Indian territory, it is the product of the appellant. While providing any technical know-how, the specifications, marketing strategies and even providing promotional services to GDPL, appellant is actually providing those services to sell, the product marketed being the product of the appellant itself. GDPL is merely a Contract Bottling Unit (CBU).

ML-52

Reliance placed on the decision of Redico Khaitan Ltd.(supra) and also *BDA Pvt. Ltd vs. CCE 2015 (40) STR 352 (Tri.- Del.) = 2015-TIOL-3074-CESTAT-DEL* which has been affirmed by Hon'ble Supreme Court in *Commissioner vs. BDA Pvt. Ltd 2016 (42) STR J 143 (S.C.)* wherein it was held that under the contract bottling arrangement falling in the alcoholic industry, the bottler is providing services to the principal manufacturer/ the brand owner and that the fee received whether in the form of surplus/profit by the principal manufacturer or the brand owner is not liable to service tax. The appellants here are rendering services to themselves. The same cannot be categorized as BAS.

c) Agreement with WMIL is for providing *inter-alia* promotion, marketing, and even customer care services for which the appellant even has received certain consideration. We are of the opinion that every intention and purpose of the agreement of appellant with WMIL is centered to market the product of affiliate and sale thereof for which the promotion and marketing activities are cantered essentially to be carried out without which business of WMIL could not sustain. Such activities are essentially being envisaged under BAS. Hence, to that extent, the Order has no infirmity and the said demand is accordingly upheld.

d) In respect of an agreement with WGS, it is observed that WGS is an entity based outside India. There has been a Notification No. 6/99 dated 9-4-1999 providing an exemption to taxable services where consideration was received in convertible foreign exchange. Though this exemption was withdrawn vide another Notification No. 2/2003-ST w.e.f. 1-3-2003, but subsequently *vide* Notification No. 21/2003– ST dated 20-11-2003, the exemption was restored. CBEC Circular No. 56/5/2003–ST dated 25-4-2003, *vide* which it was clarified that the service tax is consumption based tax and it is not applicable on export of services. Export of services would continue to remain tax-free even after withdrawal of Notification No. 6/99 dated 09.04.1999. The Hon'ble Supreme Court in the case *WPIL vs. CCE 2005 (181) ELT 359 (S.C.) = 2005-TIOL-51-SC-CX-LB* has held that in case an exemption is withdrawn and again reinstated and during the interim period, there is no change in the policy of the Government, then the later Notification reinstating the exemption is mere clarificatory in nature and would hence have retrospective effect. The retrospective application thereof was very much logical specially in absence of any intermediary Government policy supporting the withdrawal. The Order, therefore, is held to suffer infirmity while considering the export of service as a Business Auxiliary Services. Hence, to that extent, it is liable to be set aside.

e) As regards invocation of the extended period, it is held that two out of three of the agreements are held to not to be the agreements for providing Business Auxiliary Services. One, in accordance of the terms of the agreement as a whole thereof and another in terms of the exemption Notification for export services. It is only the third agreement which has been upheld as an agreement for providing Business Auxiliary Services by the appellant. There has been tremendous confusion/uncertainty about the status of Contract Bottling Units and about the taxability of export services. In such circumstances and also in view that the appellant though has been registered for service tax but not as a provider of Business Auxiliary Service but as the recipient of goods transport service only. Resultantly, no suppression of facts can be alleged against the appellant. It has been settled even by Hon'ble Supreme Court that the burden of establishing intent to evade payment of tax is that of the Department and that the same must be established with cogent positive evidence. There was no justification by the Department to invoke the extended period of five years while issuing SCN. Hence, the demand is beyond the period of one year and as such is held not sustainable.

Citation: 2018-VIL-385-CAL-ST

Case: Infinity BNKE Infocity Private Limited vs. Union of India & Ors

Background facts of the case

The petitioner sought a declaration that sub-rule (2) of Rule 5A of the Service Tax Rules, 1994 as substituted by notification no. 23/24/ST dated December 25, 2014 is arbitrary and in conflict with provisions of Section 72A of the Finance Act, 1994. The petitioner also sought a declaration that, the provisions of clause (k) of sub-section (2) of Section 94 of the Finance Act, 1994 is unguided and gives uncontrolled power of delegation.

Arguments put forth

The Petitioner submitted as under:

a) The issue of *vires* of similar provisions of the Finance Act, 1994 initially came up for consideration before the Delhi High Court in 2014 (35) S.T.R. 653 - 2014-VIL-209-DEL-ST (Travelite (India) Vs. Union of India). Such provisions were held to be ultra vires.

b) It was also submitted that an appeal is pending against such judgment and order of the Delhi High Court before the Hon'ble Supreme Court of India. Subsequently, the provisions as impugned in the present writ petition were introduced. The same was struck down by the Delhi High Court in 2016 (43) STR 67 - 2016-VIL-282-DEL-ST (Mega Cabs Pvt. Ltd. Vs. Union of India).

c) Accordingly, it was submitted that, since the provisions have been struck down, the notice impugned herein issued on such basis needs to be quashed also.

Decision

a) Since sub-rule 2 of Rule 5A of the Service Tax Rules, 1994, as substituted by notification dated December 25, 2014, was declared *ultra vires* by Mega Cabs Pvt. Ltd. (supra) - 2016-VIL-282-DEL-ST, it would be appropriate to grant an interim stay of the proceedings. Such stay will continue till November 30, 2018, or until further orders, whichever is earlier.

b) Accordingly, the petition filed by the assessee was listed for hearing in November 2018 and the proceedings are stayed till then.

Citation: 2018-VIL-632-CESTAT-HYD-ST

Case: Hindustan Coca-Cola Beverages Private Limited Vs Commissioner of CE, ST Visakhapatnam

Background facts of the case

The appellant herein is the manufacturer of aerated water under the brand names of Coca-Cola, Fanta, Limca, Thumbs up, Sprite and are paying Central Excise duty. In addition, the appellant also sources these products from their sister unit and also other franchisee bottlers to cover to the market demands. Therefore the appellant is

a) Manufacturing these products

b) Trading these products after purchasing from other units

c) Procuring these products from sister units and selling them.

The appellant has availed CENVAT credit and have opted to avail CENVAT credit on common input services and reverse the CENVAT credit under Rule 6(3A) in respect of exempted goods and services. But while calculating the exempted services, the Appellants did not consider the value of products which were procured from sister units and sold.

Further, the SCN also alleged that the reversal of CENVAT Credit should be made considering the entire cenvat credit & not cenvat related to common inputs and input services.

Arguments put forth
The Assessee as Appellants submitted as under:

a) The trading activity which they had undertaken is an exempted service while the goods which are manufactured are dutiable goods. When they purchase bottles from other bottlers and sell them it amounts to trading and the value of said activity has been reckoned for calculating the amount of CENVAT credit to be reversed. Further, they are not purchasing bottles from the sister units and selling it does not amount to trading. They are receiving the goods from the sister units under the cover of stock transfer note, and this transfer does not amount to sale of goods because the appellant's sister unit and the appellants are one at the same entity. Therefore, the value of the goods which they procure from the sister units and sell should not be reckoned while calculating the CENVAT Credit to be reversed.

b) As far as the position with reversal of entire CENVAT Credit for ratio purpose, the Appellants stated that if this position is taken it will lead to the situation where they will be deprived of some amount of CENVAT credit on inputs and input services used exclusively in relation to the manufacture of taxable goods which is not the intention of the CENVAT Credit Rules.

c) It was also argued that they have intimated to the Department regarding the reversal of credit on trading activity and other also disclosed the details of the credit in their ER-1 returns. Therefore, they cannot be alleged to be suppressed facts with an intention to evade tax. Therefore, no extended period can be invoked in their case.

The Respondent submitted as under:

a) The Hon'ble High Court of Gujarat in the case of *Sintex Industries Ltd., [2013 (287) ELT 261] - 2012-VIL-141-GUJ-CE* even two units which are a single legal entity with the common boundary wall should be treated as to separate Central Excise registrants and the assessee is entitled to credit on eligible inputs utilized in generation of electricity to the extent to which it was used to produce electricity within its factory registered for the purpose but not to the extent it was supplied to a factory registered as a different unit even though both are parts of the same legal entity and have the same PAN.

Decision

a) This issue has been settled by the Hon'ble High Court of Gujarat in the case of Sintex Industries Ltd., (supra) that as far as the CENVAT credit is concerned, what is relevant is not whether assesses are a single legal entity or not and whether they have a common PAN or not even whether the two units share a common area. What is relevant is whether they are separate registrants under the Central Excise.

b) In the present case, an appellant is procuring bottlers from their sister units on excise invoices issued in their name along with the stock transfer challans. Thereafter, the assessee is selling the goods to their customers. When specifically asked by the Bench, the Learned Counsel said that he is not sure how the money got transferred to the sister units and said that it will probably be through account adjustment by their head office; otherwise, the sister units will keep spending money to produce bottles and the appellant keeps earning selling them. There must be a mechanism of transfer of the sell products or some part of it back to the manufacturing in sister units. These being from the same legal entity, it is possible that this transfer gets done through book adjustments by their accounts Department. Thus, the Bench observe that when the appellant procures bottlers from their sister units and sells them, there is an element of trading involved. It is at par with the procurement of bottles from bottlers and selling except from the fact that they are not directly paying their suppliers for the bottles supplied.

c) A perusal of the formula for reversal shows that the amount of credit to be reversed is proportionate to the value of exempted goods and services to the total value of goods and services (both exempted and dutiable or taxable) to the "total CENVAT credit taken on input services". In view of the plain language in which the Rule is drafted, there is no scope to read the words "total CENVAT credit taken on input services" as "total CENVAT credit taken on common input services" as sought by the Appellants. The Appellants also argued that they will be put to disadvantage as a result. However, equity has no place in fiscal statutes and they should be read as they are written without any indentment. Further, Rule 6 of CENVAT Credit Rules, 2004 itself gives several options for the assessee to choose from and they chose this option. If this did not suit them, they could have taken another option

d) As far as the extended period of recovery under Section 11A(4) is concerned, it is mentioned in para 11 of the show cause notice that the assessee were requested *vide* multiple letters to submit details of trading goods using common input services. But, the assessee had submitted only partial details in reply to this letters and thereby had not disclosed the full details required for calculation for arriving at the proportionate credit attributable to the exempted goods.

e) Accordingly, the appeal filed by the Appellants was rejected.

Citation: 2018-VIL-641-CESTAT-DEL-ST

Case: The Executive Engineer vs. C.C.E & ST Jaipur

Background facts of the case

The factual matrix relevant for the adjudication is that the appellant is a holder of service tax registration under the category of "Telecommunication Service". The said telecommunication services are being provided by the appellant under the name and style of Universal Service Operator (USO) having telecommunication operator like M/s. Bharti Hexacom Ltd. Jaipur, M/s. Reliance Communication Ltd, Jaipur, M/s. Vodafone Jaipur being the service recipient of telecom towers installed by BSNL at various sites in Rajasthan. The said service is also being received by M/s. CMTS, BSNL Jaipur. M/s. CMTS, BSNL, Jaipur is the unit of the Appellants under the same PAN but has a separate registration under service tax

Department alleged that since appellant is collecting monthly charges from the other Telecommunication Operators and discharging their tax liability under the law, they are liable for discharging the same qua M/s. CMTS as well. It is alleged that appellant issue monthly debit note upon M/s. CMTS and book the amount as income in their books of account. However, appellant is not considering this amount as taxable. Resultantly show cause notice was served upon the appellant raising the demand along with the appropriate interest and the proportionate penalty.

Arguments put forth

The assessee as Appellants submitted as under:

a) It is submitted on behalf of the appellant that the appellant is none but the electrical division of BSNL which is M/s. CMTS, BSNL in Jaipur. The object of this division is to upkeep and maintain telecom tower installed by BSNL. Various telecom services providers are the service recipient of the appellant, the electrical division of BSNL. It is mentioned that the demand raised by the department is not sustainable as far as the use of the tower of BSNL by CMTS BSNL is concerned both being the same entity.

The Respondent submitted as under:

a) The separate registration under service tax make the entities as two different concern as that of an associated concern. Thus there is no wrong in the order under challenge.

b) It was also impressed upon Section 67 of the Finance Act, 1994 the explanation thereof as has rightly been considered by the adjudicating authority below. It is impressed upon that bare reading of this provision makes it abundantly clear that even the book adjustment qua the transaction of taxable services with any associated enterprise are taxable.

Decision

a) M/s. BSNL was incorporated as a Central Government Company for this purpose but its policies are totally formulated by the Department of Telecommunication Government of India. BSNL is providing telecom services in different Circles in India and different offices/ units under one circle of BSNL cannot be treated as associated enterprises as these are not intermediaries in the management of or control or capital of the other enterprises as required for being associated enterprises as per Section 92 A of the Income-tax Act, 1961.

b) Here in this case both the appellant and CMTS-BSNL are units/office of one and the same company i.e. BSNL. In view thereof the Bench was of the opinion that the adjudicating officer has not appreciated the fact that monthly advice debit notes from one unit EE-BSNL, Jaipur are nothing but transfer of expenses through book entry to another unit of the same Circle and for taxability under the service tax law, it is mandatory that the services has to be provided to a different unit and the receiver of the taxable service must be a distinct entity.

c) For the provision of service, there has to be a service provider as well as a service recipient. Tribunal in the case of *Saturday Club Ltd. vs. Asstt. Commr, Service Tax* as held that there should be existing two entities for having transactions as against consideration. In the present case, the Bench observed that the same is not the situation

d) Accordingly, the appeal filed by the Appellants was allowed.

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> Do not spend your energy in talking, but meditate in silence. Accumulate power in silence and become a dynamo of spirituality.
>
> — *Swami Vivekananda*

Janak C. Pandya, *Company Secretary*

CORPORATE LAWS

Company Law Update

[2018] 210 Comp Cas 341 (NCLAT)

[Before the National Company Law Appellate Tribunal – New Delhi]

R. Systems International Ltd., In Re

The provisions of section 66 of the Companies Act, 2013 ("CA13") shall not apply if National Company Law Tribunal (the "Tribunal") has passed the order to compromise or make arrangements with the creditors and members and allowing the reduction of share capital under section 230 of the CA13.

Brief Details

The appeal has been filed by R. Systems International Ltd (the "Appellant") against the Order of the Tribunal, New Delhi Bench. The Appellant had filed the Scheme of Arrangement (the "Scheme") under section 230 of the CA13 read with the Companies (Compromises, Arrangements and Amalgamations) Rules, 2016. The said Scheme contemplated the reduction of the share capital. The Tribunal has dismissed the application for the approval of the Scheme. The Tribunal in its order has stated that the process and petition for approval of the reduction of capital have been prescribed separately under section 66 of the CA13 and hence approval for the same cannot be clubbed within the framework of section 230 of the CA13.

Judgment

The NCLAT has allowed the application and set aside the Tribunal order. The NCLAT has remitted the case to the Tribunal to decide the same as per section 230 of the CA13.

NCLAT has analysed the provisions of section 66 related to the reduction of share capital and section 230 on compromises, arrangements and amalgamations under CA13. It has further analysed the provisions of section 391 of the Companies Act, 1956. The NCLAT has observed that the Tribunal has referred to the provisions of section 66 read with rule only for rejecting the application under section 230 of the CA13. It has observed that the explanation to section 230 provides that "... provisions of section 66 shall not apply to the reduction of share capital effected in pursuance of the order of the Tribunal under this section." The NCLAT has noted that the Tribunal has failed to notice the explanation to section 230, which states that provisions of section 66 shall not apply. The NCLAT has also referred and relied on the earlier decisions of

(1) Hon'ble Bombay High Court in *Investment Corporation of India Ltd.'*, in re *[1987] 61 Comp Cas 92 (Bom),*

(2) Hon'ble High Court of Gujarat in *Gujarat Ambuja Exports Ltd., In Re [2003] (CCI) –GJX-0113 (Guj.); [2004] 118 Comp Cas 265 (Guj.),*

(3) Hon'ble High Court of Madras in Panasonic Appliances India in CP No. 331 of 2013 and

(4) Hon'ble High Court of Andhra Pradesh in *Jyoti Inraventures Ltd., in CP No. 263 of 2013 vs. High Courts* allowing the reduction of capital under section 391 of the Companies Act, 1956.

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ML-58



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 Circular, Notification & updation of Master Directions issued by RBI:

A. Updated through A.P. (DIR Series) Circulars

1. External Commercial Borrowings (ECB) Policy – Liberalisation

a) Amendment vide AP. Dir. Series Circular No. 9 dated 19th September, 2018.

Current Guidelines provided under Para 2.4.1 and 3.3.3 of Master Direction No.5 on "ECB, Trade Credit, Borrowing and Lending in Foreign Currency by AD and Persons other than AD", are amended as under :-

- <u>ECBs by company in Manufacturing Sector:</u> Presently, ECB up to USD 50 million or its equivalent can be raised by eligible borrowers with minimum average maturity period of 3 years.

  RBI has now allowed ***eligible ECB borrowers who are into manufacturing sector to raise ECB up to USD 50 million or its equivalent with minimum average maturity period of 1 year.***

- <u>Underwriting and market making by Indian banks for Rupee denominated bonds (RDB) issued overseas</u>: Presently, Indian banks, subject to applicable prudential norms, can act as arranger and underwriter for RDBs issued overseas and in case of underwriting an issue, their holding cannot be more than 5 per cent of the issue size after 6 months of issue.

  RBI has now permitted ***Indian banks to participate as arrangers/underwriters/ market makers/traders in RDBs issued overseas subject to applicable prudential norms.***

b) Amendments *vide* AP Dir. Series Circular No. 10 dated 03th October, 2018.

Current Guidelines provided under Para 2.4.5, 2.4.6 and 2.5 of Master Direction No.5 on "ECB, Trade Credit, Borrowing and Lending in Foreign Currency by AD and Persons other than AD", has been amended as under :-

- Presently, ECB can be raised under tracks I and III for working capital purposes if such ECB is raised from direct and indirect equity holders or from a group company, provided the loan is for a minimum average maturity of 5 years.

RBI, in a measure of liberalisation permitted ***Public sector Oil Marketing Companies (OMCs) to raise ECB for working capital purposes with minimum average maturity period of 3/5 years from all recognized lenders under the automatic route.***

- *Further, the individual limit of USD 750 million or equivalent and mandatory hedging requirements as per the ECB framework have also been waived for borrowings under this dispensation. However, OMCs should have a Board approved forex mark to market procedure and prudent risk management policy, for such ECBs.*

(Comments: The above changes in the ECB policy framework by RBI, in the short run, are intended to support Indian Rupee which has rapidly declined against USD and other major world currencies)

B. Updated through Notifications

a) Amendment in Inbound Investment notified *vide* FEMA Notification No. 20 through Notification No. 20(R) (3)/2018-RB dated 30-8-2018

RBI has made following changes in the Inbound Regulations effective from **1st day of September, 2018.**

1) Amendment to Regulation 13 – Reporting Requirement :

A. The existing **clause (1)** of sub-regulation 13.1 relating to Advance Remittance is **deleted**. This amendment is necessary in light of consolidation of various forms under Single Master Form (SMF).

B. The existing **clause (11)** of sub-regulation 13.1 relating to Downstream Investment is **substituted** with the following namely:

Clause 11) Downstream Investment:

i. An Indian entity **or an investment vehicle** making downstream investment in another Indian entity which is considered as indirect foreign investment for the investee Indian entity in terms of these Regulations, shall notify the Secretariat for Industrial Assistance, DIPP within 30 days of such investment, even if capital instruments have not been allotted, along with the modality of investment in new / existing ventures (with / without expansion programme).

ii. **Form DI:** An Indian entity or an investment Vehicle making downstream investment in another Indian entity which is considered as indirect foreign investment for the investee Indian entity in terms of Regulation 14 of these Regulations shall file Form DI with the Reserve Bank within 30 days from the date of allotment of capital instruments.

iii. After the existing clause (12) of sub-regulation 13.1, the following is **inserted** as **Clause (13)** namely: "**Form InVi** : An Investment vehicle which has issued its units to a person resident outside India shall file Form InVi with the Reserve Bank within 30 days from the date of issue of units."

(Comments: These amendments are in line with new reporting requirements under Single Master Form (SMF). Through this amendment, RBI has also mandated reporting by Foreign Investment Vehicles which was hitherto absent)

b) Amendment in FEMA Notification No. 22(R) FEMA – (FEM-Establishment in India a BO/LO/PO or any other place of business) *vide* Notification No. 22(R) (1)/2018-RB dated 31-8-2018

RBI has made following amendments in the provisions realting to Establishment of Branch, LO, Project Officer, etc. to be effective from **31st August, 2018** as follows:-

1) **Amendment to Regulation 5**:- RBI has now provided that if the applicant who wants to establish an Office in India and if it is a Non-Government Organisation, Non-Profit Organisation and Body/ Agency/Department of a foreign Government and **if such entities are engaged, partly or wholly, in any of the activities covered under Foreign Contribution (Regulation) Act, 2010 (FCRA), they shall obtain a certificate of registration under the said Act and shall not seek permission under this regulation.**

2) **Amendment to Form FNC (Annex C)**:- In the existing form FNC (Annex C), **in Part–II**, under the heading **'Declaration', in clause (ii),** at the end of the existing sentence, the following further declaration is inserted, namely:

"We will not undertake either partly or fully, any activity that is covered under Foreign Contribution Regulation Act, 2010 (FCRA) and we understand that any misrepresentation made or false information furnished by us in this behalf would render the approval granted under the Foreign Exchange Management (Establishment in India of a branch office or liaison office or a project office or any other place of business) Regulations, 2016, automatically as **void ab initio** and such approval by the Reserve Bank shall stand withdrawn without any further notice".

(Comments: This will enable RBI to regulate NGOs/NPOs/and Body/Agency/Department of a foreign Government under provisions of the FCRA Act.)

C. Updated through Master Direction

1) **FED Master Direction No.19/2015-16 – Master Direction – Miscellaneous. (Updated as on 10th September, 2018)**

Sr. No.3 and Sr. No. 9 of Para 10 (Operating Framework for facilitating outward remittance services by non-bank entities through Authorized Dealer (Category-I) Banks in India) has been updated as under:

3) The remittances facilitated under this model shall comprise small value transactions, not exceeding USD 5000 per transaction, ***except for overseas education where the limit shall be USD 10000 per transaction***[1]. Remittances by resident individuals will be subject to the limit prescribed under the Liberalised Remittance Scheme (LRS).

9) The remitter's moneys should be kept distinct from service provider's operating account and such moneys should be duly protected from insolvency risks of the facilitating service provider. The onus of ensuring the security of the remitters funds shall be on the Authorized Dealer (Category I) bank.

2) **FED Master Direction No.4/2015-16- Master Direction – Compounding of contravention under FEMA, 1999. (Updated as on 19th September, 2018)**

In Para 7 (Scope and Procedure for Compounding) – Guidance Note on Computation Matrix has been updated as under:

Type of Contravention	Existing Formula
2) <u>AAC/ APR/ Share certificate delays</u> : In case of non-submission/ delayed submission of APR/ share certificates (FEMA 120) or AAC (FEMA 22) or FCGPR (B) or FLA Returns - FEMA 20 / FEMA 20 (R) / ***FEMA 120***	₹ 10000/- per AAC/APR/ FCGPR (B)/FLA Return delayed. Delayed receipt of share certificate – ₹ 10000/- per year, the total amount being subject to ceiling of 300% of the amount invested.

(Comments: RBI through amendments in Compounding Regulations, have introduced standard late filing Fees. This will bring the required transparency and greatly reduce pendency of compounding burden on the RBI)

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[1] Inserted with effect from 7th September, 2018.

CA Khurshed Pastakia

In Focus – Accounting and Auditing

Critical Analysis of Report on Audit Quality Review for 2017-18

The Quality Review Board (QRB) was constituted under section 28A of the Chartered Accountants Act, 1949 with the following aims:

- To make recommendations to the Council with regard to the quality of services provided by members of the Institute;
- To review the quality of services provided by the members of the Institute including audit services; and
- To guide the members of the Institute to improve the quality of services and adherence to the various statutory and other regulatory requirements.

The QRB annually publishes a report on the findings of inspections that it has undertaken during the year which may be in respect of audits performed by firms for an earlier accounting period(s). This report points out deficiencies in the quality of audit services provided by the members of the Institute in terms of following the requirements of both, standards on auditing and accounting standards. Since the significant findings are reported by the QRB to the Institute's Council and Disciplinary Committee, it becomes imperative for all practitioners to be aware of them and take measures to ensure that in their own firms such deficiencies do not exist.

Out of the engagements reviewed, 7% were found to contain deficiencies where significant improvements were required, 54% were found to contain deficiencies where improvements were required, and the remaining 39% were found to be generally acceptable. 61% of the engagements inspected, therefore, had deficiencies either in complying with standards on auditing, or accounting standards, or both. This is a high percentage by any reckoning.

Let us discuss the key areas where the deficiencies were found:

Standards on Auditing

1. SQC-1, Standard on Quality Control

- The first observation of QRB in this case was a blanket failure on part of audit firms to establish and implement policies relating to SQC-1. Quality in audit is the essence of professional practice, and not having policies and procedures to ensure quality would indeed be a significant deficiency that could even invite disciplinary action from the Institute. Firms that have ignored complying with SQC-1, even after almost ten years of the standard becoming mandatory, would be well advised to set up a working group to thoroughly understand the standard and take urgent steps to establish and implement quality controls. The Institute has published an *Implementation Guide to SQC-1* which should be a very useful tool.

- The second observation of QRB is failure to establish and implement policies in two specific areas: (i) engagement quality control, and (ii) human resources.
  - o Engagement Quality Control Review (EQCR): Under the chapter on Engagement Performance, paragraphs 60 to 73 deal with EQCR (see also paragraphs 5.11 to 5.13 of the *Implementation Guide to SQC-1*). EQCR essentially requires a second person review of an audit or attest engagement BEFORE the engagement partner signs the auditor's report or certificate. The purpose of this review is to ensure that all auditing and accounting standards and other laws and regulations applicable to the engagement have been appropriately followed and documented.

    EQCR, also sometimes called a "cold review", should ideally be performed by another partner or a professional with significant experience who has played no role in the engagement. This could be a problem in a sole proprietorship where there are no partners or in small firms where there is only one partner effectively looking after audit practice. In such firms there is often a shortage of employed senior professionals as well. Under such circumstances, such firms could have an arrangement with a competent outside professional who could perform the EQCRs for it.

    EQCR is an extremely versatile tool to point at possible lapses in meeting standards, laws or regulations, or the firm's internal audit approach methodology. Very often the engagement team is working under time or resource constraints and could miss out on some of the key requirements. A cold review by an unconnected outsider would throw up these flaws in time for the engagement team to rectify them before the engagement is signed-off, and so to reduce audit risk to a minimum.

  - o Human Resources (HR): Element 4 of SQC 1 (paragraphs 36 to 45) deals with human resources (see also paragraphs 4.1 to 4.8 of the *Implementation Guide to SQC-1*). It needs to be recognised that the single largest asset of a professional firm is its people. It is by using this asset effectively that a professional firm is able to exist and to render quality services to its clients. The quality of its people differentiates one firm from another in the audit marketplace.

    SQC-1 deals with HR in two parts: (i) policies around recruitment, performance evaluation, capabilities, competence, career development, promotion, compensation, and estimation of personnel needs; and (ii) assignment of engagement teams. While the former set of policies caters to the firm in general, the latter set of policies is about which of those personnel are assigned to a given engagement.

    Admittedly, in a small firm there will be few employees and the firm leadership may feel it pointless to have formal policies in place for them. While this view might be popular, people who work for an organisation need to have a clear understanding of what is expected of them and what they need to do about it, rather than undefined arbitrariness. Firms, however small, are therefore urged to establish simple but definite written policies in respect of the areas specified in the standard.

As regards assignment of personnel to engagements, the risk involved is that people who lack knowledge or experience may be assigned to perform a given audit. This exposes the firm and its leadership to a huge and avoidable risk. In cases where an engagement requires the use of personnel with specialised skill sets or relevant experience, and where the firm does not have such personnel on its rolls, it should either not accept such engagement, or hire temporary personnel with the requisite knowledge and experience (perhaps on contract basis) to perform such assignment.

- The third observation of QRB is failure to reduce familiarity threat to an acceptable level. Auditor independence is discussed under Ethical Requirements in SQC-1. The threats and safeguards approach to auditor independence lists five threats to independence that could perhaps be minimised by instituting safeguards. These are: (i) self interest threat, (ii) self review threat, (iii) advocacy threat, (iv) familiarity threat, and (v) intimidation threat. The familiarity threat is self-evident and arises when auditors form relationships with the clients where they end up being too sympathetic to the interests of the client. For example, a close relative of the audit team working in a senior position in the client company, former partner of the audit firm being a director or senior employee of the client, acceptance of gifts or hospitality from the client, etc. One of the axioms of auditor independence is that an auditor should not only be independent of his client but should also be "seen to be independent".

  Familiarity threat is dealt with in paragraphs 25 to 27 of SQC-1 (see also paragraph 2.5 of the *Implementation Guide to SQC-1*). For small audit firms, a real familiarity threat may arise from close association with the client owner or executives. This happens when the same audit partner or audit manager interacts with a given client owner or executive over a sustained period of time and develops a relationship that is beyond strictly professional. Larger firms have established safeguards like compulsory audit partner rotation every five or seven years, but that may not be the case with small firms. Smaller firms should, nevertheless, establish written policies like rotating audit managers every five years, rotating audit to another partner (except in cases of sole proprietorships) every seven years, ensuring that no member of the engagement team has any relative working in a senior position in the client enterprise, no acceptance of gifts except insignificant ones (like a box of sweets on Diwali) by any member of the engagement team, etc. These policies should be monitored for compliance. With statutory audit firm rotation, this threat might be somewhat safeguarded.

- The fourth observation of QRB is failure to establish policies and procedures designed to maintain the confidentiality, safe custody, integrity accessibility and retrievability of engagement documentation. Under Engagement Performance, SQC-1 contains requirements in this regard in paragraphs 77 to 81 (also see paragraph 5.7 of the *Implementation Guide to SQC-1*; and paragraphs 14 to 16 and A21 to A24 of AS 230). Client confidentiality is an extremely important and sensitive area of conducting an audit engagement. An auditor and his personnel are privy to many client details that are not available in the public domain. Any leakage of sensitive information, knowingly or unknowingly, by engagement team personnel could expose the audit firm to immense loss of reputation and even prosecution. As such information could be documented in the audit workpaper files, security and safe custody of those files is very important so that such information does not fall into anyone's hands, including that of firm personnel other than members of the engagement and EQCR teams. At times, even members of the client staff may be unaware of information that is shared by the client leadership with their auditors and care should therefore be taken to ensure that such information is not even leaked or likely to fall into the hands of client staff who could misuse it.

Formal policies and procedures should be laid down and monitored regularly so that all personnel employed by the firm are fully aware of the procedure to be followed with regard to workpaper files, manual as well as electronic. Care should also be taken to ensure that client information obtained by the engagement team is not left overnight in the client premises where unscrupulous client personnel could look into it, make copies of it or otherwise. Electronic documentation should be password protected and access to specific workpapers should be limited to only such members of the engagement team who have need for them.

- The last observation of QRB in respect of SQC-1 may appear on the face of it to be a relatively minor one, but the QRB has rightly considered it as important. It is that in the annual independence declaration obtained by firms for its partners no date is mentioned. In the absence of a date, it cannot be established that the declaration was obtained for the year under consideration. It could have been an old declaration obtained some years ago that may be irrelevant now. Care should therefore be taken to obtain independence declarations annually from all partners and professional personnel in the firm, including those who are not performing audits (see Annexure 1 to the *Implementation Guide to SQC-1*).

2. SA 210, Agreeing the Terms of Audit Engagements

- The first observation of QRB on this subject was, once again, a blanket failure on part of practitioners to follow the standard SA 210. There was no evidence in the working papers to show that the firm had agreed with the management on the terms of the audit engagement. Agreeing the terms at the inception of an audit engagement is an important safeguard for an audit firm in order to defend itself in disputes with the client, as well as to establish the limitations on its scope in the event of fraud litigation, if any, at a later stage. Therefore, not doing so only jeopardizes the auditor's own interests.

  Generally, an engagement letter should be drafted by the audit firm and agreed with the client by both parties signing off on it before start of field work. The duration of effectiveness of an engagement letter should be the duration of an auditor's appointment. For example, if the auditor is appointed for a one year term, the engagement letter should cover that one year period; if the appointment is for five years, the engagement letter should be valid for that five year period. In case there is any change or modification of the terms (e.g. inclusion or exclusion of any allied services, or fee revision) before expiry of an engagement letter, a fresh engagement letter should be entered into with the revised terms. Appendix 1 of SA 210 contains an illustrative engagement letter that could be tailored to suit the requirements of a given engagement.

- The second observation of QRB was failure to mention management responsibility regarding preparation of financial statements in accordance with the applicable financial reporting framework. Audit is a contractual assignment between the auditee and the auditor. The objective of SA 210 is to ensure that the auditor accepts or continues an audit engagement only provided the bases upon which it is to be performed are agreed with the auditee. These bases have two aspects: (i) establishing that the "preconditions for an audit" shall exist, and (ii) that this is explicitly agreed to by the management and/ or those charge with governance.

What are "preconditions for an audit"? Paragraph 6 of SA 210 details these to include: (i) determination of the financial reporting framework to be adopted, and (ii) management's acknowledgement that it accepts its responsibility for:

- o Preparation of financial statements in accordance with the agreed framework;
- o Maintaining internal controls to ensure that the financial statements are free from error or fraud; and
- o To provide the auditor all information, documents, records, etc., that are essential for preparation of the financial statements, any additional information that the auditor may request for, and unrestricted access to personnel within the organisation from whom the auditor may want to gather evidence.

It will be seen from the above that unless the preconditions are acceptable to the client, an audit cannot be conducted. It is to commit the client to these management responsibilities as well as to a defined financial reporting framework that a management letter agreeing the terms of the audit is largely necessary.

Besides, in our auditor's report, we unilaterally include a paragraph on management's responsibilities. The question that can arise is how can an auditor claim something is the management's responsibility if he has nothing in writing to prove that such a responsibility has indeed been accepted by management? From this viewpoint also it is imperative that a management letter is carefully drafted to include the management's responsibility for the preparation of the financial statements in accordance with an acceptable financial reporting framework. A management letter safeguards an auditor from any disputes with the client, including over fees, at a later date.

3. AS 230, Audit Documentation

The first observation of QRB is that auditors have failed to prepare documentation for audit procedures performed and audit evidence obtained as required by SAs 200, 240, 250, 260, 320, 330, 500, 530, 610, 720, and SQC 1. Apart from SA 230, there are several other standards that require creation of audit documentation to evidence the performance of audit procedures and the nature of audit evidence obtained and relied upon by an auditor. The second observation of the QRB is that auditors have failed to prepare sufficient appropriate documentation to evidence audit procedures performed for CARO, 2015 reporting. Finally, the QRB has commented that failure to prepare adequate documentation for work performed *indicates that the firm has not carried out appropriate audit procedures.*

Coming from a government regulatory board, this is a very damaging indictment indeed for any firm to get and, if referred to the Institute's Disciplinary Committee, there would be little to prevent the firm and its partners from being declared as negligent in the performance of their duties.

As has been repeated in various fora, firms that have not invested in the culture of documentation need to urgently do so.

4. SAs 300, 315, 320 and 330, Risk Assessment and Responses to Assessed Risks

These standards pertain to performing a risk-based audit. The QRB has four findings in this area.

- The second observation is a failure to perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and assertion level. Once again, this is a blanket failure to follow the auditing standards. Auditors need to appreciate that with changing times, they need to keep abreast of changing requirements in the profession and not following auditing standards can be a serious threat to their own professional practice. Without doing formal risk assessment, they cannot evidence that they adequately responded to assessed risk and the entire audit that they might have done loses its validity and exposes their work to regulatory challenge.

- The first observation of QRB is failure to document nature, timing and extent of test of control procedure to address the risk arising from control environment and not considering material related party transactions as high risk item. There are actually two separate observations here. First, that controls testing has not been documented, which implies that it has not been performed. One needs to realise that while the concept of test-check as a method to reach a conclusion about the whole population of transactions remains valid, the nature, timing and extent of test-check to be performed can be determined only after the performance of tests of controls. Test-check pre-supposes the existence of robust internal controls to prevent or detect errors or frauds in the population *that is not tested*. But that pre-supposition cannot be "assumed". Internal controls need to be tested to see if they exist, are implemented, and are operating effectively, to reach a conclusion that the control environment is such that it can be relied upon. In case of corporate entities, in any case, there is a requirement for the auditor to provide a specific report on internal controls.

- The other part of the observation is failure to consider material related party transactions as high risk item. Many years back, there used to be a false belief among some auditors that management knows best how to do its business and that, as auditors, they therefore cannot challenge management's judgement. This belief is not sustainable. An auditor has to exercise professional skepticism to go behind the outer face of transactions and challenge them in case he senses a risk of management override of internal controls or any improper conduct on part of management or those charged with governance that could amount to fraud. Many frauds are routed through related party transactions and it therefore becomes imperative for an auditor to view related party transactions (particularly where the nature or amount of such transactions is material, singly or in the aggregate) as high risk items. He should design and perform specific audit procedures to reduce that high risk to a minimum.

- The third observation of QRB is failure to document nature, timing and extent of audit procedures performed for treating certain litigations and claims as non-contingent. Disclosure of contingent liabilities is a very important disclosure that enables stakeholders to understand what could go wrong with an entity's cash flows or its viability in the future. Where an entity faces or has initiated litigation, it prima facie implies that all other mutual and persuasive remedies have got exhausted and a stage has come when either party is seeking the court's help to resolve that dispute.

Under the circumstances the auditor needs to understand the details of the dispute, the prevailing laws and then exercise his professional judgement to evaluate the chances of the dispute getting resolved in the client's favour or against.

- He may take the help of discussions with the client's internal legal teams and external legal confirmations in this regard, but the opinion of a law firm *engaged by the client* to defend it in court *prima facie* lacks the professional independence required for an auditor to treat it as an expert opinion. The auditor should understand the factual and legal issues involved in the matter from the legal confirmation, but reach his own considered judgment. In other words, simply because the lawyer appointed by the client says a claim is likely to go in favour of the client, the auditor must not blindly accept that opinion without applying his own mind. Also, what is often overlooked in many such instances is the measure of interest or penalty that is likely to be imposed by the adjudicating authority in the event of defeat of the entity's case, in addition to the claimed amount. This is particularly relevant when cases drag on for years before they are finally decided.

- The fourth observation of QRB under this heading is the failure to make proper plan for overall audit strategy and nature, timing and extent of audit procedures. SA 300 deals with audit planning. Paragraph 6 of that standard says: 'The auditor shall establish an overall audit strategy that sets the scope, timing and direction of the audit, and that guides the development of the audit plan.' While admittedly less in case of audits of smaller entities, in case of larger audits, including group audits, planning an audit should occupy a very significant proportion of the overall audit time, sometimes as much as 40-45%. Planning, including strategic planning, enables the auditor to evaluate the assessed risks and tailor responses that need to be given to mitigate those risks. Those responses primarily deal with determining the nature of audit procedures to be applied; their timing, both in terms of when the testing should be performed, and for which part of the accounting period it should be performed; and the extent of testing that should be done which could range from testing internal controls, a sample of the population and/or the whole of the population. Where the risk is at the financial statement level (rather than at the assertion level), planning would involve performing focused audit procedures on a range of account balances, instead of on just a single account balance. For example, if there is an overall risk of overstatement of revenue, focused audit procedures would be required on a number of account balances on both, the income side and the expenditure side, to ensure that neither the incomes are overstated nor the expenses are understated.

5. SAs 500, 501, 505, 520, 530, 550 and 580, Audit Evidence

- Paragraph 5 of SA 200 describes the inter-relationship between an auditor's opinion and audit evidence as follows:

  "As the basis for the auditor's opinion, SAs require the auditor to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. Reasonable assurance is a high level of assurance. It is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk (i.e., the risk that the auditor expresses an inappropriate opinion when the financial statements are materially misstated) to an acceptably low level."

- Paragraph 13(b) of SA 200 defines audit evidence as follows:

  "Audit evidence – Information used by the auditor in arriving at the conclusions on which

the auditor's opinion is based. Audit evidence includes both information contained in the accounting records underlying the financial statements and other information. For purposes of the SAs:

(i) Sufficiency of audit evidence is the measure of the quantity of audit evidence. The quantity of the audit evidence needed is affected by the auditor's assessment of the risks of material misstatement and also by the quality of such audit evidence.

(ii) Appropriateness of audit evidence is the measure of the quality of audit evidence; that is, its relevance and its reliability in providing support for the conclusions on which the auditor's opinion is based."

- The first observation of QRB is failure to attend physical inventory counting and not performing audit procedures over the entity's final inventory records to determine whether they accurately reflect actual inventory count results. Paragraphs 4 to 8 of SA 501, *Audit Evidence – Specific Considerations for Selected Items*, deals exclusively with the audit evidence requirements with regard to inventory. Manipulation of inventory is one of the popular means of carrying out management fraud. Failure to perform any audit procedures around inventory, therefore, would be regarded as professional negligence.

- The second observation of QRB is failure to prepare audit documentation for analytical procedures, audit sampling, identification of risk of material misstatement in audit strategy and identifying related party transactions. When all these items are clubbed by QRB under "audit evidence" it means that the QRB recognises that absence of documentation is an absence of audit evidence: the implication being that the audit was signed off without the auditor having a basis for his auditor's opinion.

Analytical procedures are used to perform substantive testing to reach an opinion about the appropriateness of an account balance. There is an elaborate method involving several stages as described in SA 520 to perform analytical procedures. In the absence of documentation neither the auditor himself nor an experienced auditor (under SA 230) would be able to review the work done.

Audit sampling (SA 530) deals with sampling for both, controls testing and substantive testing. By sampling, an auditor seeks to reduce the extent of his substantive audit work after assuring himself that the internal controls are adequate and reliable. Faulty sampling could lead to what is known as sampling risk which is the risk that the auditor's conclusion based on a sample may be different from the conclusion if the entire population were subjected to the same audit procedure. This could lead to a material misstatement not being detected and result in the auditor issuing an incorrect conclusion in his auditor's report. It is important to document the basis for sampling, the method used and the results obtained in order to evidence that due care was taken to select an appropriate sample, that all items in the population had a fair chance to get selected, and that the results of errors discovered were projected into the whole population to evaluate (SA 450) if likely errors in the untested population do not exceed the materiality (SA 320).

Risks of material misstatement in the financial statements are identified during the risk assessment process described in SA 315. A lack of documentation of such risks implies that the auditor did not care to identify such risks and performed his audit nevertheless. This implies that a risk-based audit was not carried out.

And, finally, a lack of documentation for identifying related party transactions would mean (i) that the auditor did not consider related party transactions as carrying a much higher (fraud) risk, and (ii) that the auditor failed to perform the special procedures in response to the risks of material misstatement associated with related party transactions as per SA 550.

- The third QRB observation is that the auditors failed to obtain sufficient amount of external confirmations and in the manner required and absence of alternative procedures in case of not using external confirmations. The standard dealing with external confirmations is SA 505. The QRB comment speaks of three failures in meeting the requirements of the standard: (i) not enough confirmations were obtained, (ii) the manner in which confirmations were obtained was inappropriate, and (iii) where confirmations were not obtained, the auditor did nothing in the way of alternative procedures to mitigate the risk of material misstatement. External confirmations are obtained to evidence several important assertions in the financial statements namely: deposits, borrowings, legal matters, property title deeds, PPE held by third parties, investments held by others, inventories held by third parties, receivables, creditors, bank balances, group company transactions and balances, etc. External confirmations are strong evidences and therefore of significant audit value. In the absence of external confirmations, alternate audit procedures (which would be weaker evidence) need to be performed. Some auditors are found to make little effort in following up and procuring external confirmations after sending out requests for confirmation. If the confirmations do not come, they resign to that fate and do nothing more to audit the assertion. This is incorrect and dangerous because oftentimes the amounts involved are material.

- The fourth observation by QRB under this heading is failure to obtain written representations from management. SA 580 deals with written representations to be obtained from management. During the course of an audit, the management gives many oral explanations to queries raised by the auditor and his assistants. Some of these explanations are of a significant nature. If the auditor accepts such explanations he is in fact accepting and relying on oral evidence. Oral evidence is the weakest evidence for an auditor to rely upon. That is why SA 580 deals at length with and requires an auditor to obtain written representations from management (management representation letter)

- The last observation of QRB on this topic is failure to obtain appropriate audit evidence for reporting requirements u/s. 143(3)(g) of the Companies Act, 2013. This sub-section deals with the assertion that an auditor makes in his auditor's report about whether any director is disqualified from being appointed as a director u/s. 164(2). The assertions that are required to be made in the auditor's report under the Companies Act should be enumerated during the planning stage for the purpose of risk assessment and response to risks and necessary audit procedures should be laid down in the audit programme to cover the audit of all such assertions. Oftentimes, these are omitted from the main audit programme and looked into only at the finalization stage when the report is getting composed. This leaves little time to obtain and document sufficient appropriate audit evidence.

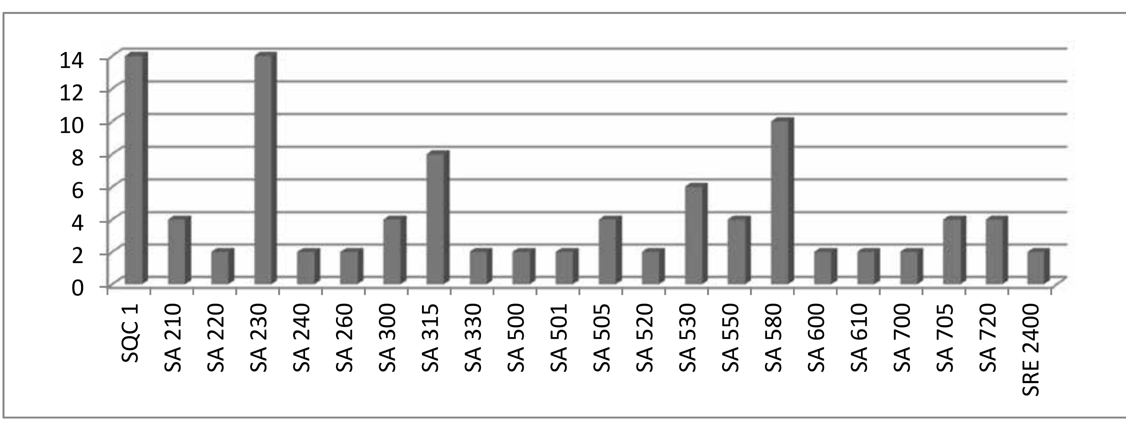
6. SAs 700, 705, 706, and 720, Audit Conclusions and Reporting

- QRB has given three observations in respect of the reporting standards. The first is failure on part of the auditors to prepare their auditor's report in the specified format. This is a rather unexpected comment from the regulator as generally one would expect all auditors to be sufficiently knowledgeable about something as basic as the format of the auditor's report. What this shows is that some auditors are completely out of touch with the requirements of contemporary audit and need to read the auditing standards before undertaking audit assignments.

- The second observation is failure of auditors to include a Basis for Qualified Opinion paragraph when they choose to qualify the auditor's report. To my mind, this flows from the first comment where some auditors might still be using the erstwhile auditor's report format that was used under the Companies Act 1956, and not the report format as per SAs 700, 705 and 706.

- The third and final observation of QRB is that they found inconsistencies in other information as defined in SA 720 and financial statements. SA 720 deals with the auditor's responsibility with regard to other information included in documents containing the audited financial statements. Examples of documents containing the audited financial statements could be a company's annual report or prospectus. An auditor is required to "read" this other information (such as director's report, chairman's speech, MD&A, other data including financial charts and diagrams, claims made in the prospectus about the company's performance, financial strength, cash flows, etc.) to see if it contains information that is inconsistent with the information contained in the audited financial statements. In case of inconsistencies, the standard provides guidance on the response to be made by the auditor. It would be fair to say that sometimes it is difficult to obtain such other information before the audit sign-off date. But the auditor needs to be strict with the client in demanding to read such other information.

Percentage of Firms having observations in various Standards



Standards on Auditing

Accounting Standards

The observations of the QRB in accounting standards are quite straightforward and do not require much in the way of explanation or commentary. These are listed below standard-wise. Where there is any need for elaboration, the same is supplied in brackets.

AS 1, Disclosure of Accounting Policies

- Failure to disclose all significant accounting policies adopted in the preparation and presentation of financial statements.

AS 3, Cash Flow Statements

- Failure to report separately major classes of gross cash receipts and gross cash payments arising from investing activity. (Sometimes accountants show only the net cash flows from investing activity rather than gross. Cases where net position may be presented are specifically mentioned in the standard.)

- Classifying fixed deposits having maturity of more than three months as CCE. (It needs to be noted that the period of three months is the original maturity period at the inception of the deposit, and not the period left for the deposit to mature after reporting date. See paragraph 6 of Standard and the related Guidance Note)

- Failure to report the effect of changes in exchange rates on CCE held in foreign currency as a separate part of the reconciliation of the changes in CCE during the period. (See paragraph 25 of the Standard)

- Failure to disclose the method of preparing Cash Flow Statement. (The Standard allows two alternatives. The alternative selected by management needs to be disclosed as an accounting policy choice)

- Failure to disclose dividend distribution tax as cash flow from financing activity. (Dividend payout should be shown gross and not net of tax.)

AS 6, Depreciation

- Failure to depreciate assets over the balance lease period. (See also paragraph 18 of AS 19)

- Failure to disclose depreciation rates or the useful lives of the assets on being different from the rates specified in Schedule II of the Companies Act, 2013. (Where a departure is made from the scheduled rates, which are not appropriate in the circumstances, a disclosure is required to elaborate the actual position)

AS 9, Revenue Recognition

- Failure to disclose the excise duty related to the difference between closing stock and opening stock in the Statement of Profit & Loss. (Excise duty component has to be separately disclosed)

- Failure to recognise certain other income on accrual basis.

- Failure to disclose accounting policy on dividend income from investments in shares. (See paragraphs 8.4 and 8.5 of the Standard)

- Failure to disclose revenue from sales transactions on face of the Statement of Profit and Loss. (See paragraph 2 of General Instructions for Preparation of Statement of Profit & Loss Schedule III of Companies Act, 2013)

AS 13, Accounting for Investments

- Failure to recognise decline, other than temporary, in the value of long-term investments. (See paragraph 17 of the Standard)
- Failure to show interest and dividend from long-term and current investments separately. (See paragraph 25(b)(i) of the Standard)

- Failure to show profit or loss on disposal of long-term and current investments separately. (See paragraphs 25(b)(ii) & (iii) of the Standard)

AS 15, Employee Benefits

- Failure to disclose the requirements as specified in paragraph 120(n) and (o) of AS 15.
- Failure to disclose information about defined benefit plans. (See paragraph 120 of the Standard)

AS 16, Borrowing Costs

- Failure to disclose amount of borrowing cost capitalised during the year. (See paragraph 23(b) of the Standard)
- Failure to capitalise borrowing cost as part of cost of qualifying assets. (See paragraph 6 of the Standard)

AS 20, Earning per Share

- Failure to present basic and diluted earnings per share on the face of the Statement of Profit & Loss. (See paragraphs 8 and 9 of the Standard)

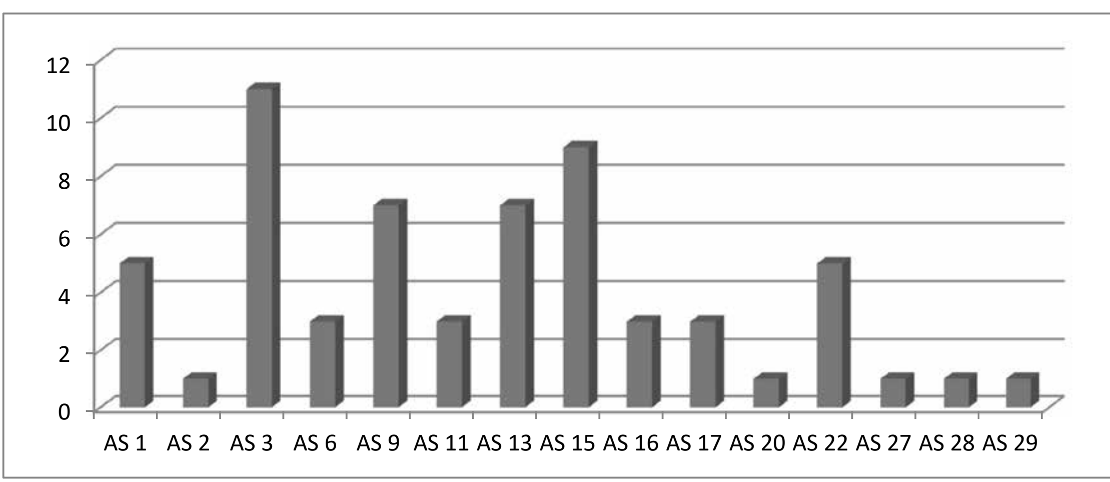
AS 22, Accounting for Taxes on Income

- Recognition of deferred tax assets despite the fact that there was no record of virtual certainty that sufficient future taxable income will be available against which such deferred tax assets can be realised. (See paragraph 17 of the Standard)
- Failure to review the carrying amount of deferred tax assets at each balance sheet date in terms of paragraph 26 of AS 22.
- Failure to take deferred tax effect in respect of depreciation charged to retained earnings.

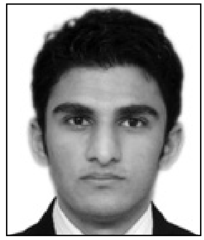
AS 28, Impairment of Assets

- Failure to disclose carrying amount of fixed assets at the beginning and at the end of the period. (See paragraph 119 of the Standard)
- Failure to disclose impairment information for reportable segment as per paragraph 120 of AS 28.

Percentage of firms having observations in various standards



Accounting Standards



Rahul Sarda, *Advocate*

Best of the Rest

1. Insolvency and Bankruptcy Code – Proceedings u/s. 138 of Negotiable Instruments Act – Whether maintainable during moratorium?

The appellant filed complaint under Section 138 of the Negotiable Instruments Act, 1881 before the Metropolitan Magistrate prior to initiation of Corporate Insolvency Resolution Process in case of the debtor-company. Another complaint u/s. 138 of said Act was filed after initiation of Corporate Insolvency Resolution Process, i.e., after the order of moratorium. The respondent-directors moved before the NCLT and argued that during the period of moratorium proceeding petition under Section 138 of NI Act was not maintainable. The NCLT directed the appellant to withdraw the complaint case filed treating it as a proceeding filed after order of moratorium with observation that such action amounts to deliberate attempt on the part of appellant and sheer misuse of the process of law.

Held by the NCLAT, Section 138 is a penal provision, which empowers the Court of competent jurisdiction to pass order of imprisonment or fine, which cannot be held to be proceeding or any judgment or decree of money claim. Imposition of fine cannot be held to be a money claim or recovery against the corporate debtor nor order of imprisonment, if passed by the Court of competent jurisdiction on the Directors, they cannot come within the purview of Section 14. Further held that no criminal proceeding is covered under Section 14 of I&B Code and the Court of competent jurisdiction may proceed with the proceeding under Section 138 of Negotiable Instruments Act, 1881 even during the period of moratorium.

Shah Brothers Ispat Pvt. Ltd. vs. P. Mohanraj & Ors., Company Appeal (AT) (Insolvency) No. 306 of 2018 dated 31st July 2018 – NCLAT (New Delhi)

2. Civil Procedure Code, O VII, R. 3 – Description of immovable property – Sketch map not placed on record

The plaintiffs filed the suit seeking measurement of suit land, fixing boundaries and for recovery of the encroached area. The defendants, in their written statement, stated that the suit ought to be dismissed on the ground that a rough sketch map was not annexed to the plaint. The trial reached the stage of delivering the judgment. However, the plaintiff sought an amendment and also sought to bring on record the map. The Trial

Court did not allow the plaintiff to bring on record the map at such a late stage on the reasoning that sufficient opportunity was available to the plaintiff and even though the defendants had specifically raised this objection.

Held, on a petition by the plaintiffs, that there were certain defects which could be cured before it was too late. Further held that identification of immovable property was a curable defect and default or carelessness of litigating sides would not absolve the trial Court of its obligations while scrutinising the plaint. Therefore, the petition was allowed and the plaintiff was permitted to bring on record the map.

Dattatraya Kashinath Mandekar vs. Changdeo Dagdu Khule, 2018 (4) Mh.L.J. 584 (Bom.)

3. Insolvency and Bankruptcy Code – Loan disbursed without interest – Could not be considered as "financial debt"

The applicant had advanced a loan to the respondent corporate debtor. However, the corporate debtor failed to repay debt and the applicant claiming to be financial creditor filed petition under Section 7 against the corporate debtor.

Before the NCLT, neither any loan agreement had been placed on record nor any supporting evidence/document to establish applicable rate of interest to be paid on said loan. The applicant had failed to prove that loan was disbursed against consideration for time value of money, particularly when the respondent company had affirmed that no interest had been paid nor payable at any point of time. Held, mere grant of loan and admission of taking loan will *ipso facto* not treat the applicant as 'financial creditor' within the meaning of section 5(8). Therefore, it was held that the instant claim could not be termed to be a 'financial debt' and the applicant could not come within meaning of 'financial creditor'. Held where loan was disbursed to corporate debtor without applicable rate of interest, loan was not against consideration for time value of money and could not be considered as financial debt and, hence, applicant who had disbursed such loan was not financial creditor to be eligible to file petition under section 7. Therefore, petition filed under section 7 was to be dismissed as not maintainable.

Ravinder Pal Singh Lamba vs. Satkar Air Cargo Services (P.) Ltd. [2018] 97 taxmann.com 186 (NCLT – New Delhi)

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CA Anish Thacker & CA Parag Ved, *Hon. Jt. Secretaries*

The Chamber News

Important Events and happenings that recently took place are reported as under:

PAST EVENTS

1. DIRECT TAXES COMMITTEE

Direct Tax Update Series Lecture meeting on the subject " Alleged Suspicious Transactions in Shares was held on 4th Octoer,2018. The meeting was addressed by Dr K.Shivaram, Senior Advocate.

2. INTERNATIONAL TAXATION COMMITTEE

The Certificate Course on MLI was held on 5 & 6th October, 2018. The course was inaugurated by Mr A.A.Shanker, Principal CCIT and Key Note address was delivered by Mr Hemant Kumar Sarangi, CCIT, International Tax. Eminent faculties in the field of International taxation addressed the conference. The course received good response from the delegates.

3. INDIRECT TAXES COMMITTEE

Workshop on GST Annual return and GDST Audit Report was held on 6th October,2018 which was addressed by CA Ashit Shah and CA Parind Mehta. The workshop received overwhelming response with attendance of 250 delegates.

4. RRC & SD COMMITTEE

The Capital Market Study Circle was held on 5th October, 2018 on the subject "Emerging Trends ion Equity Markets in this Turbulent Times and way forward" jointly with Interact Foundation and NSE. The meeting was addressed by Mr Dilip Bhatt, Jt. MD Prabhudas Liladhar Pvt Ltd and Mr Ajay Bodke, CRO and CPM, Prabhudas Liladhar Pvt Ltd.

5. LAW & REPRESENTATION COMMITTEE

The L & R committee made following representations during the month.

1 Extension of time for filing Form DIR 3 KYC of persons holding DIN Nos issued before 31st March,2018

(For details of the future programmes, kindly visit www.ctconline.org or refer to The CTC News of October, 2018)

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Membership & Public Relations Committee

Full Day Seminar on "Issues in Accounts Finalisation & Return Reconciliation with Amendments in GST" held jointly with Goa Chamber of Commerce & Industry on 7th September, 2018 at Panaji, Goa

Dignitaries on the Dais Seen from L to R: S/Shri Gaurav Kenkre, Convenor, GCCI Taxation Committee, CA Mandar Telang, Faculty, CA Hinesh R. Doshi, President, CA Naresh Sheth, Faculty, Vishant Gaonker, State Dy. Commissioner, GST, Yatish Vernekar, Convenor, GCCI Taxation Committee and CA Parimal Kulkarni, Chairman, Taxation Committee, GCCI

Faculties

CA Mandar Telang

CA Naresh Sheth

CA Hinesh Doshi, President giving Opening Remarks, Seen from L to R: S/Shri CA Parimal Kulkarni, Chairman, Taxation Committee, GCCI, Sandeep Bhandari, President, GCCI, K. Anabalagan, Central GST Commissioner

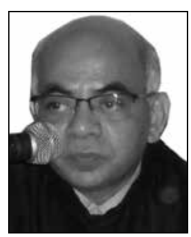
Direct Taxes Committee

Webinar on "Filing of Trust Returns with Income Tax and Charity Commissioner Office" held on 15th September, 2018

Faculty
CA Apurva Shah

Indirect Taxes Committee

Indirect Tax Study Circle Meeting on "GST Implication for Charitable Trust, Co-Operative Society and NGO" held on 5th October, 2018



Chairman
Mr. Shailesh Sheth, Advocate

Faculty
Mr. Rahul Thakar, Advocate

International Taxation Committee

Intensive Study Group on International Taxation held on 18-9-2018 on the subject "E-Commerce Taxation – Key Consideration".

Faculty
CA Jasdeep Sahani

ISG on International Taxation Meeting on "Taxation Trends in Digital & E-commerce arena" held on 1st October, 2018

Faculty
Dr. Amar Mehta

RRC & SD Committee

Capital Market Study Circle Meeting held on 5th October, 2018 at IMC, Churchgate on the subject "Emerging trends in Equity Market in these Turbulent times and way forward"

CA Bhavesh Joshi, Chairman, welcoming the speakers and members. Seen from L / R: Ms. Dhwani Sanghavi, Faculty, CA Narendra Mehta, Interact Foundation, Shri Ajay Bodke, Faculty, Shri Dilip Bhat, Faculty, CA Hinesh R. Doshi, President, CA Charu Ved, Co-ordinator.

CA Charu Ved, Co-ordinator, introducing the Speakers. Seen from L to R: Ms. Dhwani Sanghavi, Faculty, CA Narendra Mehta, Interact Foundation, Shri Ajay Bodke, Faculty, Shri Dilip Bhat, Faculty, CA Hinesh R. Doshi, President, CA Bhavesh Joshi, Chairman.

Faculties

CA Narendra Mehta,
Interact Foundation

Shri Dilip Bhat,
Jt. MD, Prabhudas Lilladher
Pvt. Ltd.

Shri. Ajay Bodke, CEO,
Prabhudas Lilladher
Pvt. Ltd.

Ms. Dhwani Sanghavi
NSE

Bengaluru Study Group Meeting

Inaugural Meeting of Bengaluru Study Group held on 21-9-2018 at FKCCI, Bengaluru

CA Hinesh R. Doshi, inaugurating the meeting by lighting the lamp. Seen from L to R: S/Shri CA Jagdish Punjabi, Faculty, CA H. Padamchand Khincha, Advisor, CA Narendra Jain, Convenor

CA Hinesh R. Doshi, giving opening remarks. Seen from L to R: S/Shri CA Hanish S. co-ordinator, CA Vishnu Bagri Convenor, CA H. Padamchand Khincha, Advisor, CA Tata Krishna, co-ordinator & CA Narendra Jain, Convenor

CA H. Padamchand Khincha, Advisor addressing the members

CA Jagdish Punjabi addressing the members on the subject "Overview of Benami property Law"

CA P. Srinivasan, addressing the members on the subject "Significant Economic Presence"

Group Photo

Chambers warm welcome to Mr. A. A. Shanker, new Principal Chief Commissioner of Income Tax in Mumbai, who was pleased to know about Chambers activities. Seen from L to R: S/Shri CA Hitesh R. Shah, Past President, CA Hinesh R. Doshi, President, Mr. A. A. Shanker, Pr. CCIT, CA Mahenra Sanghvi, Chairman, L & R. Committee, CA Anish Thacker, Jt. Hon. Secretary,

International Taxation Committee

Certificate Course on MLI held on 5th & 6th October, 2018 at Hotel West End, Mumbai

CA Hinesh Doshi inaugurating the conference by lighting the lamp. Seen from L to R: S/Shri CA Anish Thacker, Hon. Jt. Secretary, CA Rajesh P. Shah, Chairman, Shri A. A. Shanker, Pr. CCIT, CA Ronak Doshi, Co-ordinator, Shri Hemant Kumar Sarangi, CCIT Int. Tax, (WZ)

Dignitaries at the Inaugural Session

Shri Hinesh Doshi, President giving Opening Remarks, Seen from L to R: S/Shri CA Rajesh P. Shah, Chairman, Shri A. A. Shanker, Pr. CCIT, Shri Hemant Kumar Sarangi, CCIT Int. Tax (WZ), CA Ronak Doshi, Co-ordinator.

Shri Rajesh P. Shah, Chairman welcoming Chief Guest, Seen from L to R: S/Shri CA Hinesh R. Doshi, President, CA Rashmin Sanghvi, Faculty, Shri Hemant Kumar Sarangi, CCIT Int. Tax (WZ), CA Shreyas Shah, Convenor

Shri A. A. Shanker, Pr. CCIT, delivering inaugural address.

Shri Hemant Kumar Sarangi, CCIT Int. Tax (WZ), delivering keynote address.

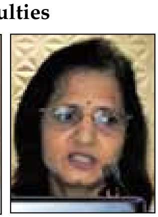
Faculties

CA Rashmin Sanghvi

CA Radhakishan Rawal

CA Vispi T. Patel

CA Bhaumik Goda



CA Geeta Jani

CA Jiger Saiya

CA Vishal Gada

Mr. Sanjay Sanghvi, Advocate

Direct Taxes Committee

Direct Tax Update Series Lecture Meeting on the "Rule of Evidence in Assessment, Penalty and Prosecution Proceedings (with special reference to alleged suspicious transactions in shares)" held on 4th October, 2018 at IMC, Churchgate

CA Hinesh R. Doshi, President giving opening remarks

CA Devendra Jain, Chairman welcoming speakers and members. Seen from L to R: Dr. K. Shivaram, Faculty, CA Hinesh R. Doshi, President, CA, Nimesh Chotani, Convenor

Faculty: Dr. K. Shivaram, Sr. Advocate

Indirect Taxes Committee

Half Day Workshop on GST Annual Return & GST Audit Report held on 6th October, 2018 at IMC, Churchgate

CA Hinesh Doshi, President giving opening Remarks, Seen from L to R: S/Shri CA Hemang Shah, Convenor, CA Naresh Sheth, Chairman, CA Ashit Shah, Faculty, CA Kush Vora, Convenor.

CA Naresh Sheth, Chairman, welcoming Speakers & Delegates, Seen From L to R S / CA Hemang Shah, Convenor, CA Ashit Shah, Faculty, CA Hinesh Doshi, President, CA Kush Vora, Convenor

Faculties

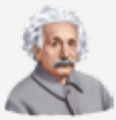
CA Ashit Shah

CA Parind Mehta

Section of Delegates.

FAYDELAL KE FUNDE

BENEFITS OF COMPOUNDING



Albert Einstein - *"Compound interest is the eighth wonder of the world."*

Why is it so? Let us understand

In Compounding, interest is generated not only on the initial invested amount but also on the previously accumulated interest.

Reap the benefits of Compounding by investing early to achieve your financial goals.

Let us understand with an example

Mr. A

age 25

Starts investing

Mr. B

age 40

Starts investing

for their retirement

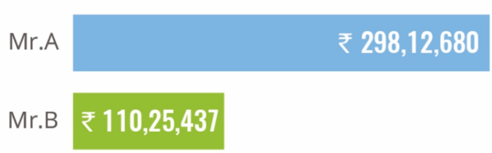
When they turn **60,** they both had invested ₹ **35,00,000** each.

However, their investment or holding value were different.

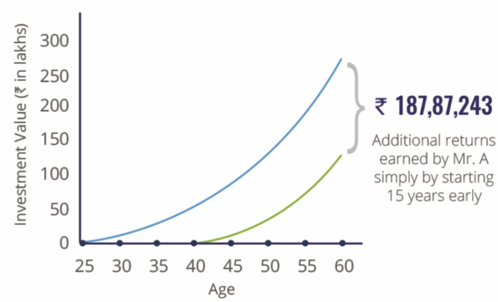
Let us see what is their investment value when they turn 60.

Value of Investment

We assumed that both earned 10% returns (compounded annually) on their investment



Let us see how their investment grew over years



Benefits of Compounding

1. Starting early gives you the benefit of investing smaller amounts
2. Staying invested for longer helps you in getting better returns
3. Proper planning can help you achieve your financial goals

FAYDELAL KE FUNDE

Time is the best wealth creator -

The earlier you start and longer you stay invested, more rewarding it is !

Hence avoid delays in investing

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